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EDITOR'S NOTE

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ocketed:
une 19, 1985

Title: Federal Deposit Insurance Corporation., Petitioner
v.
Philadelphia Gear Corporation

Court: United States Court of Appeals
for the Tenth Circuit

Counsel for petitioner: Solicitor General

Counsel for respondent: Slattery Jr., Gerald F.

ntry	Date	Note	Proceedings and Orders
1	May 9 1985		Application for extension of time to file petition and order granting same until June 19, 1985 (White, May 10, 1985).
2	Jun 19 1985	G	Petition for writ of certiorari filed.
3	Jul 19 1985	G	Motion of Council on International Banking, Inc. for leave to file a brief as amicus curiae filed.
4	Jul 24 1985		DISTRIBUTED. September 30, 1985
5	Aug 28 1985	R	Response requested.
6	Sep 24 1985		Brief of respondent Philadelphia Gear Corp. in opposition filed.
7	Oct 2 1985		REDISTRIBUTED. October 18, 1985
8	Oct 16 1985	X	Reply brief of petitioner FDIC filed.
9	Oct 21 1985		Motion of Council on International Banking, Inc. for leave to file a brief as amicus curiae GRANTED.
10	Oct 21 1985		Petition GRANTED. **********
11	Dec 6 1985		Looging received. To be returned to Dept. of Justice.
12	Dec 5 1985		Brief amicus curiae of U.S. Conference of Mayors, et al. filed.
13	Dec 5 1985		Brief amicus curiae of National Association of Bond Lawyers filed.
14	Dec 2 1985		Brief amicus curiae of Council of International Bank filed.
15	Dec 4 1985		Brief amicus curiae of The American Bankers Assn., et al. filed.
16	Dec 5 1985		Brief of petitioner FDIC filed.
17	Dec 10 1985		Record filed.
18	Dec 10 1985		Certified copy of C.A. proceedings received.
19	Dec 17 1985		Record filed.
20	Dec 17 1985		Certified copy of original record, 6 volumes received.
21	Dec 27 1985		Joint appendix filed.
22	Jan 7 1986		SET FOR ARGUMENT, Tuesday, March 4, 1986. (1st case)
23	Jan 8 1986		Brief amicus curiae of William H. Allen, et al. filed.
24	Jan 10 1986		Brief of respondent Philadelphia Gear Corp. filed.
25	Jan 13 1986		CIRCULATED.
26	Feb 25 1986	X	Reply brief of petitioner FDIC filed.
27	Mar 4 1986		ARGUED.

PETITION FOR WRIT OF CERTIORARI

84-1972

No.

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CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1984

FEDERAL DEPOSIT INSURANCE CORPORATION,
PETITIONER

v.

PHILADELPHIA GEAR CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

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QUESTION PRESENTED

Whether a standby letter of credit is a deposit within the meaning of 12 U.S.C. 1813(*l*)(1) for purposes of the federal deposit insurance program.

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In the Supreme Court of the United States

OCTOBER TERM, 1984

No.

FEDERAL DEPOSIT INSURANCE CORPORATION,
PETITIONER

v.

PHILADELPHIA GEAR CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

The Solicitor General, on behalf of the Federal Deposit Insurance Corporation, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Tenth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-19a) is reported at 751 F.2d 1131. The February 9, 1984 order of the district court (App., *infra*, 20a-45a) is unreported.

JURISDICTION

The judgment of the court of appeals (App., *infra*, 19a) was entered on December 27, 1983. A petition for rehearing was denied on February 19, 1985 (App., *infra*, 46a). On May 10, 1985, Justice White

extended the time within which to file a petition for a writ of certiorari to and including June 19, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Orion Manufacturing Corporation (Orion) produced drilling equipment. One of its suppliers was respondent, the Philadelphia Gear Corporation. App., *infra*, 2a. On April 23, 1981, on Orion's application, Penn Square Bank, N.A. (Penn Square), a national banking association doing business in Oklahoma City, Oklahoma, issued a so-called standby letter of credit for the benefit of respondent in the amount of $145,200.[1] The letter was intended to

[1] A standby letter of credit functions as a guarantee mechanism in which the issuing bank (the "issuer") undertakes to pay a third party (the "beneficiary") in the event that the bank's customer does not itself make payment to the beneficiary when due. The issuer generally must make payment on the letter when the beneficiary presents documents establishing the customer's default. See generally Comment, *The Independence Rule in Standby Letters of Credit*, 52 U. Chi. L. Rev. 218, 219-220, 222-226 (1985). Such letters typically are unfunded (that is, they are not supported by funds on deposit with the bank), because banks do not anticipate having to pay out on them; the customer simply guarantees that the bank will be reimbursed if it is forced to pay out on the letter. In contrast, traditional "commercial" letters of credit are not contingent on a default. They function as a payment mechanism; in the typical case, the letter will obligate the issuing bank to pay the seller of goods upon the presentation of a bill of lading indicating that the seller has made delivery to the buyer, the bank's customer. See *id.* at 218-219. Such letters generally are backed (or funded) by the customer's placement of funds into an account in the issuing bank in an amount sufficient to pay the seller. See U.C.C. § 5-117, official comment (1985); Resnick, *The Risky New Wrinkles in Letters of Credit*, N.Y. Times, Nov. 11, 1984, § 3, at 8-9. See generally Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716 (1973).

guarantee that respondent would receive payment for its equipment in the event of a payment default by Orion (App., *infra*, 5a). To this end, the letter obligated Penn Square to pay Philadelphia Gear upon receipt of the latter's "signed statement that [it] ha[d] invoiced Orion * * * and that said invoices ha[d] remained unpaid" (*id.* at 3a). As security for this undertaking, Orion executed an unsecured "back-up" note in the amount of $145,200 in favor of Penn Square, which the bank would draw upon for reimbursement if it was forced to pay respondent under the letter of credit (*id.* at 3a, 6a, 23a). Although this condition was not expressed in the note, both Orion and Penn Square "understood that nothing would be considered due on this note nor would interest be charged unless and until [respondent] presented to Penn Square the requisite documents detailed in the letter of credit" (*id.* at 5a).

On July 2, 1982, the Comptroller of the Currency declared Penn Square insolvent, and appointed the Federal Deposit Insurance Corporation (FDIC or Corporation) as its receiver pursuant to 12 U.S.C. 1821(c). Over the next several weeks respondent sought payment from the FDIC in its capacity as receiver (which is distinct from the FDIC's corporate role as insurer of bank deposits) under the letter of credit, citing defaults by Orion that had occurred prior to the bank's failure but that had not been presented to the bank at that time. The FDIC as receiver, however, refused to honor drafts on the letter of credit. App., *infra*, 4a.

Respondent then brought this suit, claiming that the letter was a "deposit" insured by the FDIC under

12 U.S.C. 1813(*l*)(1), which in relevant part defines a deposit as—

> [T]he unpaid balance of money or its equivalent received or held by a bank in the usual course of business and * * * which is evidenced by * * * a letter of credit * * * on which the bank is primarily liable: *Provided*, That, without limiting the generality of the term 'money or its equivalent', any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for * * * a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable.

As the beneficiary of the letter, respondent maintained that it was a depositor entitled to the statutory maximum of $100,000 in insurance proceeds (App., *infra*, 2a, 4a). See 12 U.S.C. 1821.

2. The United States District Court for the Western District of Oklahoma ruled for respondent. The court explained that, "although the letter of credit was not issued in exchange for legal tender, it must be *considered* as having been issued in exchange for 'money or its equivalent' because it was issued in exchange for Orion's promissory note" (App., *infra*, 40a; emphasis in original). The district court then found that Penn Square had been "primarily liable" on the letter (*id.* at 40a-41a).

In relevant part, the court of appeals affirmed.[2] The court premised its opinion on the understanding that Congress had not "explicitly delegated to the FDIC authority to refine the definition of a deposit contained in § 1813," and that the Corporation had not in any event promulgated regulations "pinpointing § 1813's precise meaning" (App., *infra*, 8a).

[2] The court of appeals overturned the district court's award of prejudgment interest to respondent (App., *infra*, 15a-16a).

In these circumstances, the court concluded that the FDIC's views on the meaning of the statute were due no special deference (*ibid.*).[3]

With this understanding of the weight that should be given the FDIC's views, the court began its opinion by holding that Penn Square had received "money or its equivalent" in connection with the letter—that is, Orion's unsecured back-up note. While the court acknowledged that both Orion and Penn Square understood that "nothing would be considered due on the note" until Orion defaulted and respondent made a proper demand, it nonetheless found that the note was negotiable on its face (App., *infra*, 6a) and thus, evidently, was by its nature the equivalent of money. And even apart from the negotiability of the note, the court found the "money or its equivalent" aspect of Section 1813(*l*)(1)'s definition satisfied simply because "[t]he bank's customer had signed a promissory note obligating it to repay advances made by the bank" (App., *infra*, 6a).

Rejecting the FDIC's proposed distinction between commercial and standby letters of credit, the court next concluded that the letter in this case was one on which "the bank [was] primarily liable." Again declining to accord the FDIC deference, the court found that "[t]he liability of a bank issuing a standby letter of credit is nearly absolute," because the bank must pay claims against the letter even if the customer has "ordinary" defenses to payment, such

[3] Although these statements were made during the course of the Tenth Circuit's analysis of "primary liability" (see pages 5-6, *infra*), the court's view on the FDIC's regulatory role presumably affected its holding on the other issues in the case as well. Indeed, in the discussion of the other issues the court failed even to suggest that the FDIC has special expertise in interpreting Section 1813(*l*)(1).

as failure of consideration or fraud in the inducement. App., *infra*, 10a-11a. "[T]his facet of standby letter liability," the court concluded, "places it closer to the paradigm of primary liability" (*id.* at 10a).

Finally, the court added several further considerations in support of its conclusion. Because it found that a bank's liability under a standby letter of credit is nearly absolute, it reasoned that the FDIC will not have difficulty in determining the amount of the bank's obligations to the Corporation's insurance fund (which are based on total deposits, see 12 U.S.C. 1817). App., *infra*, 12a. And it noted that Section 1813(*l*)(1) on its face refers to letters of credit generally, without distinguishing between the different types; because Congress nowhere stated that standby letters should be excluded from the definition, "the plain language dictates the conclusion that these instruments are within the statutory definition of a 'deposit.'" App., *infra*, 13a.[4]

REASONS FOR GRANTING THE PETITION

The court of appeals' decision is based on several fundamental misconceptions. Its holding that unfunded standby letters of credit are deposits within the meaning of Section 1813(*l*)(1) disregards both economic reality and the purposes of the Federal Deposit Insurance Act: the decision affords the benefits of federal deposit insurance to the beneficiary of

[4] The court also rejected the FDIC's argument that respondent's claims were unrecorded contingent liabilities (see 12 U.S.C. ~~1822(c))~~, holding that the claims were provable because they were in existence prior to insolvency and were certain at the time that the beneficiary sued the bank's receiver (App., *infra*, 14a-15a). That conclusion is not challenged here.

a financial instrument that simply does not represent deposited funds. In so doing, the court entirely disregarded the settled views of the agency that for some 50 years has applied the current statutory definition of the term "deposit."

Despite its illogic, the decision below will have immediate, substantial and continuing effects on banking and related financial transactions in the United States. It will bring under the FDIC's insurance umbrella the almost $120 billion worth of outstanding standby bank letters of credit, while making banks liable for more than $100 million in additional annual insurance assessments. At the same time, the ruling will play havoc with the multi-billion dollar market in industrial revenue bonds, which may lose their tax exempt status if backed by an FDIC-insured letter of credit. In these circumstances, immediate review by this Court of the question presented here is appropriate.

1. At the outset, the court of appeals erred in concluding that it was entirely free to disregard the FDIC's views on the meaning of the statutory term "deposit." The court flatly asserted that the Corporation's views were entitled to no special deference here. In fact, however, the FDIC is the agency that for 50 years has administered the statutory provisions at issue, and Congress plainly has indicated that the FDIC's interpretation of Section 1813 must be accorded the greatest deference. See 12 U.S.C. 1813(*l*)(5) and 1819 Tenth. As a general matter, this background suggests that the agency's views must be given "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *Chevron U.S.A. Inc. v. Natural Resources*

Defense Council, Inc., No. 82-1005 (June 25, 1984), slip op. 5. But beyond that, on the particular question in this case, the legislative history indicates that the FDIC's construction of the statute should be dispositive.

The definition of "deposit" that now appears in Section 1813(*l*)(1) was first used in a 1935 FDIC regulation issued pursuant to the Banking Act of 1935, ch. 614, 49 Stat. 684 *et seq.*[5] The Corporation's Regulation I was in all relevant respects identical to the current Section 1813(*l*)(1), providing that "[t]he term deposit shall include * * * letters of credit on which the bank is primarily liable" when those letters are issued "[f]or money or its equivalent" or for "a charge against a deposit account." Regulation I further provided that such instruments would be deemed to have been issued for money or its equivalent when presented "in exchange for * * * promissory notes upon which the person procuring the instrument is primarily liable." 12 C.F.R. 301 and 301.1(d) (1939). Although the language of Regulation I, like that of the current statute, did not in terms exclude unfunded standby letters of credit from the definition of deposit, from the moment of the regulation's promulgation the FDIC informally but consistently declined to treat such instruments as deposits. Im-

[5] That statute defined a deposit as "the unpaid balance of money or its equivalent received by a bank in the usual course of business and for which it has given or is obligated to give credit to a commercial, checking, savings, time or thrift account, or which is evidenced by its certificate of deposit, and trust funds held by such bank whether retained or deposited in any department of such bank or deposited in another bank, together with such other obligations of a bank as the board of directors [of the FDIC] shall prescribe by its regulations to be deposit liabilities by general usage." 49 Stat. 685-686.

mediately after the regulation went into effect, for example, an FDIC official explained its meaning to banking officials and auditors as follows:

> If your letter of credit is issued by a charge against a depositor's account or for cash and the letter of credit is reflected on your books as a liability, you do have a deposit liability. If, on the other hand, you merely extend a line of credit to your customer, you will only show a contingent liability on your books. In that event no deposit liability has been created.

Transcript of Notes Taken at a Special Meeting of N.Y. Bank Comptrollers and Auditors Conference 25-26 (Sept. 27-28, 1935), quoted in *FDIC* v. *Irving Trust Co.*, 137 F. Supp. 145, 161 (S.D.N.Y 1955). From 1935 until the time of the decision below, the FDIC accordingly never has assessed insurance premiums on letters of credit of the sort at issue here—and never has paid out on insurance claims relating to such letters—because it has not treated them as deposits.

Although the Corporation's interpretation was by then a long-standing one, Congress did not disturb Regulation I when, in 1950, it substantially overhauled the federal deposit insurance program. See Federal Deposit Insurance Act of 1950, ch. 967, 64 Stat. 873 *et seq.* Indeed, Congress in 1960 *incorporated* Regulation I's language concerning letters of credit and promissory notes directly into what is now Section 1813(*l*)(1). Although the FDIC's general regulatory approach was called to the attention of Congress at that time (see *Federal Deposit Insurance Assessment: Hearings on H.R. 12465 Before the Senate Comm. on Banking and Currency*, 86th Cong., 2d Sess. 50 (1960) (statement of William G. Loeffler); *Federal Deposit Insurance Act: Hearings on*

H.R. 8916 and H.R. 8928 Before the House Comm. on Banking and Currency, 86th Cong., 2d Sess. 112-113 (1960) (statement of Royal L. Coburn)), absolutely nothing in the legislative history of the 1960 amendment expresses congressional dissatisfaction with, or an intent to depart from, the FDIC's application of Regulation I. To the contrary, the 1960 legislation was designed principally to simplify the determination of assessments owed by FDIC-insured banks. See S. Rep. 1821, 86th Cong., 2d Sess. 1 (1960).

This legislative background strongly suggests that Congress affirmatively intended to endorse the FDIC's treatment of unfunded standby letters of credit: "once an agency's statutory construction has been 'fully brought to the attention of the public and the Congress,' and the latter has not sought to alter that interpretation although it has amended the statute in other respects, then presumably the legislative intent has been correctly discerned." *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979). See *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978). And Congress did more here than decline to disturb the agency's views; it actually incorporated those views into the statute.[6]

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[6] Indeed, Congress very recently reaffirmed its long-settled view that standby letters of credit are not insured deposits within the meaning of Section 1813(*l*)(1). The Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 *et seq.*, provides that industrial revenue bonds lose their tax exempt status if they are "invested (directly or indirectly) in federally insured deposits." Pub. L. No. 98-369, § 622, 98 Stat. 919. A bond is not viewed as federally guaranteed, however, "solely because a financial institution guarantees repayment of the loans [to financial institutions] other than by means of federal deposit insurance (*e.g.*, by a letter of credit)." Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* at 941 (Comm. Print 1984). Thus, it is still the congressional view that standby letters of credit (that is, those used to guarantee payment) are not federally insured.

At the very least, the factors at work here present the clearest imaginable case for deference to the FDIC. The Corporation developed the statutory language (see *Miller* v. *Youakim*, 440 U.S. 125, 144 (1979)); the interpretation at issue involved a contemporaneous construction of that language (see *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978)) that has been followed for 50 years; Congress has expressed no dissatisfaction with the Corporation's approach, despite congressional amendment of the controlling statute (see *Lorillard*, 434 U.S. at 580-581); and, of course, Section 1813(*l*)(1) is a central portion of a complex regulatory scheme that the FDIC is charged with administering (see *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 56 & n.21 (1981)). In these circumstances, the court of appeals could appropriately have rejected the FDIC's approach only if it found "compelling indications that [the approach] is wrong." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969).

2. There are no such indications in this case. To the contrary, the FDIC's interpretation of the term "deposit" is the only one that is faithful both to the statutory language and to the congressional purpose. The federal deposit insurance program, of course, is intended "to prevent the destruction of deposits because of bank failure and to protect depositors against loss." S. Rep. 1821, *supra*, at 2. And because it is only a "customer who delivers his own funds to the bank [who] risks their total or

partial loss if the bank should suspend operations" (*Irving Trust*, 137 F. Supp. at 162), Congress has provided that insured deposits basically are defined as "money or its equivalent received or held by a bank." 12 U.S.C. 1813(*l*)(1); see 12 U.S.C. 1813 (*l*)(2)-(5). If the bank's customer has not entrusted the bank with anything of value, then, there is no deposit in existence that warrants the protection of federal deposit insurance.

a. Section 1813(*l*)(1) provides that an instrument must be regarded "as evidencing the receipt of the equivalent of money" when a bank issues it in exchange for, among other things, a "promissory note"; the court of appeals in this case held that the unfunded letter here in dispute fell within this proviso because Penn Square issued it in exchange for Orion's unsecured back-up note. But the Orion note plainly was not a "promissory note" of the type that Congress intended to describe when it enacted Section 1813(*l*)(1). In reality, the standby letter functioned as a line of credit that Penn Square offered to its customer, Orion, for the benefit of respondent; as such, the letter had to be included in Penn Square's calculation of its statutory lending limits. See, *e.g.*, 12 C.F.R. 208.8(d)(2) and 337.2(b). Orion's back-up note served simply to secure this undertaking. Under the controlling understanding between Orion and Penn Square (see App., *infra*, 5a-6a), the liability evidenced by the note was wholly contingent—through the note, Orion simply undertook to repay a debt that might arise in the future if certain contingencies occurred—so that the note created no present indebtedness and bore no interest.

Such a contingent instrument is in no economic sense the equivalent of money. Neither Orion nor respondent deposited any funds with or obligated themselves to entrust anything of value to the bank when Orion obtained the note. And because the note did not represent an existing debt, Penn Square could not realistically expect to obtain value for it. Thus, Penn Square at no point during the transaction functioned as a depository, and Orion at no point had its "own funds [at] * * * risk[] * * * [had] the bank * * * suspend[e]d operations." *Irving Trust*, 137 F. Supp. at 162. In these circumstances, treating the letter of credit secured by Orion's back-up note as an insured deposit would frustrate the purposes of the federal deposit program and provide respondent with a windfall, because nothing of value ever was deposited with Penn Square.

That the Orion note was not a "promissory note" within the meaning of Section 1813(*l*)(1) is strongly corroborated by the other terms of the statute. The proviso to the Section states that an instrument (such as a letter of credit) "must be regarded as evidencing the receipt of the equivalent of money" when issued in exchange for a promissory note or for "checks or drafts * * * or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded * * * for collection." All of these instruments have a substantial present value, and all represent unconditional obligations. Obviously, the inclusion on this list of an unsecured back-up note would have been highly anomalous. Cf. *Fedorenko* v. *United States*, 449 U.S. 490, 512 (1981). That Orion and Penn Square chose to use the statutory term by labelling their instrument a "promissory note" should not change this conclusion, for the purpose and structure of the statute make it plain that the nature of the note at issue, rather than its title,

should control its treatment for insurance purposes.[7] Indeed, it appears that the drafters of Regulation I would not have understood a contingent note to be a "promissory note" within the ordinary meaning of that term. See, *e.g.*, *Gilman* v. *Commissioner of Internal Revenue*, 53 F.2d 47 (8th Cir. 1931) (instrument is not a promissory note if there is no unconditional commitment to pay on it).

This conclusion also should not be affected by the court of appeals' finding (see App., *infra*, 6a) that the Orion note was negotiable on its face because the conditions attached to Orion's liability were not addressed in the note itself. That the note may in a technical sense have been a negotiable instrument hardly answers the question whether it was the equivalent of money for purposes of the federal deposit program. Given the agreement between the parties, Penn Square obviously could not have negotiated the note against Orion until the bank actually advanced funds to respondent. And while Penn Square conceivably could have sold the note fraudulently to an innocent third party, it is difficult to believe that Congress intended to define as "money or its equivalent" an instrument that becomes valuable only when used unlawfully. In any event, whether a particular note is negotiable has nothing to do with the purpose of the deposit insurance program: protecting funds that depositors have entrusted to banks. Here, it is undisputed that no such funds were deposited.

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[7] Similarly, it is not significant that the controlling conditions that made the note contingent were spelled out in a separate agreement between Orion and Penn Square, rather than on the face of the back-up note itself. Any other conclusion would allow the parties to such agreements to obtain federal insurance for their transactions simply by engaging in clever drafting.

b. While the court of appeals relied primarily on the promissory note proviso to Section 1813(*l*)(1) in finding that the letter of credit here was issued for money or its equivalent, the court also noted that, under the plain language of the statute, a deposit includes the equivalent of money "received or held by a bank * * * which is evidenced by * * * a letter of credit * * * on which the bank is primarily liable." Because a letter of credit is involved in this case, the court concluded that the instruments here "are within the statutory definition of a 'deposit' " (App., *infra*, 13a). But in reaching this conclusion the court of appeals entirely disregarded the first portion of the statutory definition, for here the bank did not receive money or its equivalent in exchange for the standby letter; it received only the contingent back-up note. This distinction has been accepted by the Sixth Circuit, which has held that a purchase and assumption transaction effected by the FDIC in certain failed bank situations (see 12 U.S.C. 1823(c)(2)(A)) does not transfer liability for standby letters of credit because such instruments are "contingent liabilities" that are supported by "contingent assets" (*In re F & T Contractors, Inc.*, 718 F.2d 171, 181 (1983))—an analysis that cannot be reconciled in principle with the decision below. Indeed, as we have noted, for regulatory purposes standby letters of credit issued for the account of bank customers are aggregated with loans *from* a bank (see, *e.g.*, 12 C.F.R. 208.8(d)(2) and 337.2(b)), rather than with deposits received *by* the bank.[8]

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[8] While a bank's deposits must be set forth on the liability side of its balance sheet, standby letters of credit must be disclosed only in the "general notes" to the sheet. See 12 C.F.R. 11.7(c)(9)(viii), 11.44, 206.7(e)(12)(vii), 335.621, 335.627.

In any event, there is a basic difference between a standby letter of credit and the other instruments listed in the first portion of Section 1813(*l*)(1). That portion of the statute provides that the term "deposit" means "money or its equivalent received or held by a bank * * * which is evidenced by its certificate of deposit, * * * or a check or draft drawn against a deposit account and certified by the bank, or a letter of credit or a traveler's check on which the bank is primarily liable." With the exception of letters of credit, the various listed instruments create unconditional liability of a certain value. A bank becomes liable to pay on a letter of credit only when certain conditions are met, however—and the general expectation is that, in the usual situation, the bank never will become liable on a standby letter of credit. See note 1, *supra*.

In these circumstances, "the essential test [of whether a letter of credit is a deposit] is whether the funds involved are those of the customer himself or funds of the bank which have been made available to the customer under a loan"; it is only in the first situation that the customer risks the loss of "his own funds * * * if the bank should suspend operations before they are paid out to the beneficiary or returned to the customer." *Irving Trust*, 137 F. Supp. at 162. A standby letter of credit thus cannot evidence the receipt of money or its equivalent,[9] and the fundamental error of the court below was its conclusion to the contrary.

c. The court of appeals erred for a second reason as well in rejecting the FDIC's conclusions here. A letter of credit may represent a deposit only if it was

[9] This distinction has been recognized by the Federal Reserve Board, which has excluded from its definition of "deposit" those obligations "that represent[] a conditional, contingent or endorser's liability." 12 C.F.R. 204.2(a)(2)(i).

issued for the equivalent of money *and* if the issuing bank was "primarily liable" on it. As we have shown, the letter in this case was not issued for the equivalent of money. And Penn Square—like any bank issuer of a standby letter of credit—was not in any event primarily liable on the letter within the meaning of Section 1813(*l*)(1).

While there are some ways in which a standby letter of credit differs from a simple guaranty or performance bond (see Comment, *The Independence Rule in Standby Letters of Credit*, 52 U. Chi. L. Rev. 218, 223-224 (1985)), there is little doubt that such a letter is "closely akin to a suretyship or guaranty contract." *Colorado National Bank* v. *Board of County Commissioners*, 634 P.2d 32, 37 (Colo. 1981). Indeed, standby letters often are described as "guaranty" letters of credit (see, *e.g.*, Kimball & Sanders, *Preventing Wrongful Payment of Guaranty Letters of Credit—Lessons From Iran*, 39 Bus. Law. 417 (1984); Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716 (1973)) because "[t]he bank is, in essence, secondarily liable [on a standby letter], a conceptual distinction that separates the guaranty letter of credit from traditional letters of credit." *Id.* at 725. That distinction is readily apparent here: the letter issued by Penn Square indicated on its face that respondent was required both to provide invoices and to attest to Orion's default before the bank became liable.

Viewed in this light, the court of appeals' analysis of the primary liability issue, which looked to the type of defenses that could have been asserted by Penn Square in the event of a claim by respondent, is largely beside the point.[10] The purpose of a stand-

[10] Indeed, that analysis might not even have been accurate on its own terms. Looking generally to law concerning tradi-

by letter of credit is to guarantee payment of an underlying debt, on which the customer—in this case Orion—is primarily liable. And absent fraud or other unusual circumstances, the bank's liability is in fact contingent on the customer's default. The court of appeals' finding that Penn Square was "primarily liable" on the letter in this case therefore entirely disregards the purpose of a standby letter of credit. Indeed, the court's analysis would appear to make issuing banks "primarily" liable on all letters of credit, a reading that would make the statute's use of that limiting term meaningless. In these circumstances, the FDIC's conclusion that banks are primarily liable on commercial but not on standby letters of credit plainly is reasonable. Cf. 12 C.F.R. 208.8(d)(2) and 337.2(b) (standby and commercial letters of credit accorded different treatment for purposes of bank lending limits).

3. The decision below will have an immediate and significant effect on the regulation of the banking industry and, potentially, on each of the nation's FDIC-insured banking institutions. Most obviously, the court of appeals' ruling would for the first time

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tional commercial letters of credit, the court concluded that Penn Square's liability on the letter here was "nearly absolute" (App., *infra*, 10a), whatever the state of the underlying transaction between respondent and Orion. But application of this rule may well be improper in cases involving standby letters of credit, because "the rule distorts the 'bargain-in-fact' between the parties to the underlying contract by requiring the bank to pay even when the customer has not in fact breached [his] contract [with the beneficiary]." Comment, 52 U. Chi. L. Rev. at 228-229. See Note, *"Fraud in the Transaction": Enjoining Letters of Credit During the Iranian Revolution*, 93 Harv. L. Rev. 992, 1011-1013 (1980).

accord insurance coverage to the approximately $120 billion in outstanding standby letters of credit—a development that would increase the aggregate domestic deposits held by FDIC-insured banks by some 9%, while proportionately reducing the ratio of the FDIC's insurance fund to deposits outstanding.[11] Moreover, because bank failures are not an altogether uncommon occurrence,[12] a decision that permits additional creditors to make insurance claims can be expected to impose significant new demands on the FDIC. This development is particularly troubling given the standby letter of credit's essential character as a loan to the bank's customer; as this case demonstrates, the court of appeals' decision potentially makes the federal government the guarantor of business transactions that are financed by standby letters of credit.

While aspects of this problem may be ameliorated over time through the payment by insured banks of increased insurance premiums to the FDIC, those premium adjustments in turn would impose significant new burdens on banking institutions. The FDIC generally assesses contributions to its insurance fund at 1/12 of 1% of a bank's deposits (see 12 U.S.C. 1817(b)); given the current volume of unfunded letters of credit outstanding, the FDIC would be forced

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[11] The figures estimating the amounts involved have been provided to us by the FDIC, and are derived from its annual reports and published statistics on banking, and from call reports submitted to the FDIC by banking institutions.

[12] The FDIC reports that in the years 1982-1984 there were 179 bank failures in the United States. Through mid-June, there were 47 bank failures in 1985.

to collect additional annual assessments of approximately $100 million. Indeed, the FDIC's discretionary authority to charge back assessments for a four-year period (see 12 U.S.C. 1817(g)) could make banks liable for a one-time payment (including interest) of close to $400 million. By thus increasing the cost of standby letters of credit, this development could put American banks at a serious disadvantage vis-a-vis foreign or other non-insured institutions in arranging standby letter of credit transactions. See, *e.g.*, Quint, *Bank Credit Rulings Cause Concern*, N.Y. Times, Feb. 18, 1984, at D1.[13]

Moreover, the effects of the decision below are not confined to the banking industry; the Tenth Circuit's ruling also has significant implications for the bond market. Under the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 *et seq.*, so-called industrial revenue bonds—which include many municipal bonds—are exempt from federal tax unless they are guaranteed by the federal government. Such bonds are viewed as federally guaranteed if, among other things, they are "invested (directly or indirectly) in federally insured deposits." Pub. L. No. 98-369, § 622, 98 Stat. 919. The decision below suggests that the many billions of dollars worth of such

[13] In addition, depending upon the required accounting method, treating standby letters of credit as deposits could increase bank capital requirements. FDIC-insured banks are required to maintain a minimum level of capital as a ratio to assets. If banks must carry standby letters of credit on their books as deposits, total bank assets will be increased; as a result, banks will be required to carry additional capital. See generally 50 Fed. Reg. 11128 (1985) to be codified at 12 C.F.R. 325. The FDIC estimates that, in the aggregate, this development could increase bank capital requirements by as much as $6.5 billion.

bonds that are backed by standby letters of credit (see Quint, *supra*, at D4) may be viewed as federally guaranteed, and therefore as not tax exempt. While the Internal Revenue Service recently announced that it will give "grandfather" tax exempt status to all standby letter of credit industrial revenue bond transactions issued by December 31, 1985, the uncertainty created by the court of appeals' ruling is threatening to disrupt the extraordinarily sensitive market in tax free bonds. And again, this development may give foreign or other non-insured institutions an advantage in the financing of such bond offerings. *Ibid.*[14]

[14] Because the decision below imposes new demands on the federal deposit insurance program and is disrupting the national market in industrial revenue bonds, we believe that review by this Court is warranted despite the absence of an existing conflict in the circuits on the question presented. Briefing on a case involving similar issues recently was completed in the Sixth Circuit (*Allen* v. *FDIC*, No. 85-5003) in a suit growing out of the failure of Knoxville's United American Bank. Because the default in *Allen* occurred six months after the bank's failure, however, the Sixth Circuit could rule for the FDIC simply by holding that a deposit obligation cannot be created by events occurring after the failure of a bank —a holding that would not conflict directly with the decision below. We are not aware of any other cases pending in the courts of appeals presenting similar issues.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JUNE 1985

APPENDIX A

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

Nos. 84-1901 & 84-2007

PHILADELPHIA GEAR CORPORATION,
PLAINTIFF-APPELLANT
CROSS-APPELLEE

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its official capacity as Receiver of Penn Square Bank, N.A., and FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its corporate capacity, DEFENDANTS-APPELLEES
CROSS-APPELLANTS

[Filed Dec. 27, 1984]

Appeal from the United States District Court
for the Western District of Oklahoma
(D.C. No. CIV-82-1191-W)

Before DOYLE, MCWILLIAMS and LOGAN, *Circuit Judges.*

LOGAN, Circuit Judge.

This appeal is another arising out of the many suits resulting from the failure of the Penn Square Bank, N.A. in Oklahoma City, Oklahoma, in 1982. In this case, plaintiff Philadelphia Gear Corporation seeks to enforce, as beneficiary, a standby letter of credit issued by Penn Square before its insolvency. The parties dispute the amount covered by the document. Philadelphia Gear seeks judgment against the Federal Deposit Insurance Corporation (FDIC) in its capacity as insurer for $100,000.00 in deposit insurance proceeds and seeks judgment against the FDIC as receiver of Penn Square for $624,728.50, which it alleges to be the total uninsured outstanding balance of the letter of credit. Several legal issues are presented in this appeal.

The FDIC in its capacity as insurer argues that the district court erred when it held: (1) that the standby letter of credit represented a "deposit" as defined in 12 U.S.C. § 1813(*l*)(1) and thus was an insured deposit under 12 U.S.C. § 1813(m); (2) that Philadelphia Gear was the insured depositor for purposes of the statute; and (3) that prejudgment interest should be assessed against the FDIC as insurer of the $100,000.00 deposit insurance proceeds. Philadelphia Gear, as cross-appellant, claims that the district court erred in concluding that the letter of credit is ambiguous and in construing its amount as $145,200.00 rather than the larger sum claimed by Philadelphia Gear.

I

Orion Manufacturing Corporation, a customer of Penn Square, produces pumping units for oil production in Oklahoma and Texas. Philadelphia Gear is a

trade supplier who furnished some of the major elements of Orion's pumping jacks. On April 23, 1981, Penn Square issued an irrevocable standby letter of credit upon the application of Orion for the benefit of Philadelphia Gear. The letter was for $145,200.00 and expired August 1, 1982. The letter provided that drafts drawn upon it must be accompanied by:

> "(1) Your [Philadelphia Gear's] signed statement that you have invoiced Orion Manufacturing Corporation and that said invoices have remained unpaid for at least fifteen (15) days
>
> (2) Copy of all invoices
>
> (3) All invoices will be verified for authenticity and payment with Orion Manufacturing Corporation.
>
> (4) We hereby agree with drawers, endorsers and bona fide holders of all drafts, drawn under and in compliance with the terms of this credit, that such drafts will be duly honored upon presentation to the drawer."

Pl. Ex. 1. That same day Orion executed an unsecured note in the amount of $145,200.00 in favor of Penn Square as security for the letter of credit. The maturity date of the note was August 1, 1982, the same day the letter of credit expired.

A few days later, Penn Square, at the request of Philadelphia Gear, amended the letter of credit by deleting paragraph (3), quoted above, which required invoices to be verified for authenticity, and added the following language requested by Philadelphia Gear:

> "This credit shall be automatically reinstated from time to time for any sum or sums up to

> $145,200.00 upon presentation of described documents. This credit and all reinstatements are irrevocable and shall expire on August 1, 1982."

Pl. Exs. 1 and 14.

On July 5, 1982, the Comptroller of the Currency declared Penn Square insolvent and appointed the FDIC as its receiver. Two days later Philadelphia Gear, through a remitting bank, presented to the receiver for payment three drafts on the letter of credit totalling $242,370.00. On July 22, 1982, Philadelphia Gear, in the same manner, presented to the receiver for payment five additional drafts on the letter of credit totalling $482,358.50. A few days later Philadelphia Gear received a letter dated July 21, 1982, from Penn Square's liquidator formally giving notice that the receiver disaffirmed "any and all" obligations under the letter of credit in question and stating that it would not honor any drafts thereon. During the next week, the liquidator returned unpaid all eight drafts that had been presented under the letter of credit. This litigation ensued. After the district court ruled in favor of Philadelphia Gear on all of the issues dealing with deposit insurance and in favor of the FDIC as receiver on the question of the total value of the letter of credit, both sides appealed.

II

A

The first issue we consider is whether the standby letter of credit is a "deposit" within the meaning of 12 U.S.C. § 1813(*l*)(1). That section defines a "deposit" as:

> "the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and . . . which is evidenced by . . . a letter of credit . . . on which the bank is primarily liable: *Provided*, That, without limiting the generality of the term 'money or its equivalent', any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for . . . a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable . . . ."

The district court, after examining the section's legislative history, concluded that the letter of credit satisfied § 1813(*l*)(1)'s definition of a deposit:

> "First, although the letter of credit was not issued in exchange for legal tender, it must be *considered* as having been issued in exchange for 'money or its equivalent' because it was issued in exchange for Orion's promissory note. 12 U.S.C. § 1813(*l*)(1). Second, the letter of credit itself is one on which the bank is primarily liable."

R. III, 755.

B

The FDIC argues that the "money or its equivalent received" element of the section's definition is unsatisfied because there was no advance made on the promissory note executed by Orion in favor of Penn Square before the bank became insolvent. Both Orion and Penn Square understood that nothing would be considered due on this note nor would interest be charged unless and until Philapdelphia Gear presented to Penn Square the requisite documents detailed in the letter of credit, which it had not done at the time of the bank's insolvency. The Uniform Commercial Code requires that negotiable instruments contain an

unconditional promise to pay on the part of the maker or drawer. *See* U.C.C. § 3-104(1)(b), Okla. Stat. Ann. tit. 12A § 3-104(1)(b). Consequently, the FDIC argues that Orion's note was nonnegotiable because it represented only a contingent obligation. We do not agree.

Whatever contingencies may have been orally agreed to between Orion and Penn Square, none are expressed in the note itself. The negotiability of an instrument must be determined from the face of the instrument, without regard to extraneous agreements. *See* U.C.C. § 3-105(2)(a) and Official Comment. Orion's promissory note to Penn Square is a form note with standard terms. The note states that the purpose of the loan was "Back up Letter of Credit # 1042," but it does not contain any expression that no money has been advanced. The note's negotiability is not predicated on the presentation of documents under the letter of credit. *See id.* § 3-105(1)(d) (statement that note is drawn under a letter of credit does not make promise or order conditional).

Even if we ignore the note's appearance as an unconditionally negotiable instrument, what is important here is that the bank agreed to make funds available for the benefit of its customer, Orion, and by the promissory note it secured Orion's obligation to pay the bank for any advances it made. A commercial transaction occurred that set in motion other commercial activity in reliance thereon; the bank issued a document upon which its customer's supplier could draw in lieu of relying upon the customer's own ability to pay. The bank's customer had signed a promissory note obligating it to repay advances made by the bank, with interest. Therefore, we hold that the transaction qualifies as one in which "money or

its equivalent" was issued in exchange for a promissory note.

C

The FDIC also argues that this is not a letter of credit on which the bank is "primarily" liable. To properly analyze this issue requires an understanding of the two types of letters of credit: the commercial letter, which is used to facilitate the documentary sale of goods, and the standby letter, which is used to protect a third party against the customer's default on an underlying obligation. Professor Clark describes the similarities and differences of these two documents:

> "A letter of credit (whether of the commercial or standby variety) is an engagement by an issuer (almost always a bank) to a beneficiary (such as a seller of goods), made at the request of a customer (such as a buyer of goods), that binds the issuing bank to honor drafts up to the amount of the credit upon the beneficiary's presentment of the documents required by the terms of the letter.
>
> If a commercial letter is involved, the documents will normally include a bill of lading and invoice; if a standby letter is involved, the key document will probably be a certificate of default by the customer on the underlying obligation."

B. Clark, *The Law of Bank Deposits, Collections and Credit Cards*, ¶ 8.2 at 8-5 (rev. ed. 1981) (footnote omitted).

The FDIC argues that the language in § 1813(*l*)(1) referring to letters of credit on which the bank is primarily liable was intended to refer to commercial letters and not to standby letters such as the one in-

volved in this case. The FDIC asserts that it assisted in drafting a significant portion of the statute and that it has been charged with administering the provisions of § 1813. Accordingly, it contends that its interpretation of the statute is entitled to substantial deference and should be followed absent compelling indications that it is wrong. *See Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367, 381 (1969).

We acknowledge that deference is often appropriately given to an agency's interpretation of the statute it must administer. *Federal Election Commission v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 37 (1981). This deference is particularly justified if Congress has explicitly left a gap for the agency to fill as then "there is an express delegation of authority to the agency to elucidate a specific provision of the statute by regulation." *Chevron, U.S.A., Inc. v. National Resources Defense Counsel, Inc.*, —— U.S. ——, (1984), 52 U.S.L.W. 4845, 4847 (U.S. June 25, 1984). We also note, however, that a reviewing court should consider in giving weight to an administrative position "the thoroughness evident in [the administrative body's] consideration, the validity of its reasoning, [and] its consistency with earlier and later pronouncements . . . ." *Adamo Wrecking Co. v. United States*, 434 U.S. 275, 287 n.5 (1978) (quoting *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944)).

There is no evidence that Congress explicitly delegated to the FDIC authority to refine the definition of a deposit contained in § 1813. Moreover, the FDIC has not acted as if it possessed such authority by promulgating federal regulations pinpointing § 1813's precise meaning. Consequently, we must examine the thoroughness, validity, and consistency of the FDIC's interpretation of § 1813.

The FDIC first contends that a standby letter of credit is in essence a guaranty of the account party's performance because the issuing bank's obligation is triggered only if the account party defaults on the underlying contract. It claims that standby letters of credit are of questionable legality because national banks are not empowered to act as a surety or guarantor of another party's debts. *See* 12 U.S.C. § 24; *First Empire Bank-New York v. FDIC*, 572 F.2d 1361, 1367 (9th Cir.), *cert. denied*, 439 U.S. 919 (1978).

The FDIC's position on this issue is contrary to federal regulations promulgated by the Comptroller of the Currency. *See* 12 C.F.R. § 7.7016.[1] In addition, the Comptroller expressly has included standby letters of credit in the federal regulations imposing lending limitations on national banks. 12 C.F.R. § 32.2(d) and (e). The FDIC's contention is contrary to positions taken by the FDIC in other litigation. *See FDIC v. Freudenfeld*, 492 F. Supp. 763, 767 (E.D. Wis. 1980) ("FDIC argues that a 'standby' letter of credit is not a guaranty.").

We acknowledge that a standby letter of credit is similar in many respects to a surety's contract to guaranty a principal's debt. Indeed some commentators refer to it as a "guaranty letter of credit." *See* Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716 (1973). The drafters of Article 5 of the Uniform Commercial Code re-

[1] This section states expressly that "[a] national bank may issue letters of credit permissible under the Uniform Commercial Code or the Uniform Customs and Practice for Documentary Credits to or on behalf of its customers." The Uniform Commercial Code contemplates that banks may issue standby letters of credit. *See* U.C.C. §§ 5-102(1)(a), 5-103(1)(a) and (b).

flected commercial practice when they described issuing bank's expectations that their customers will put in funds before banks make disbursements under a letter or at least reimburse a bank immediately afterwards. U.C.C. § 5-117, Official Comment. The UCC drafters also contended that the issuing bank "assumes minimum risks as against its customer." U.C.C. § 5-109, Official Comment 1.

Nevertheless, a bank issuing a standby letter assumes a significantly less conditional liability than a surety assumes at common law or an accommodation party assumes under Article 3 of the UCC. We believe this facet of standby letter liability places it closer to the paradigm of primary liability. An ordinary guarantor generally will be able to assert "real defenses," *see* U.C.C. § 3-415, even in the most extreme cases of secondary liability, as when it undertakes to guarantee payment on a negotiable instrument under U.C.C. § 3-416(1) and then attempts to assert defenses against a holder in due course. In less extreme cases, the surety may almost always assert the principal's defenses to avoid payment to a creditor. *See* J. White & R. Summers, *Handbook of the Law Under the Uniform Commercial Code* § 13-17 at 531-35 (2d ed. 1980). Issuers of standby letters have no such luxury.

The liability of a bank issuing a standby letter of credit is nearly absolute: it may dishonor a claim if there are irregularities in documents presented, *see* U.C.C. § 5-114; but otherwise it must pay claims against the letter even if the customer has ordinary defenses from the underlying transaction such as failure of consideration [2] or—analogous to Article 3 "real

[2] U.C.C. § 5-114(2) allows a "fraud in the transaction" defense against payment on a letter of credit in certain circumstances. The courts have disagreed on the scope of that exception to the ordinary rule that the issuer must pay. We express no opinion on that question, which is before us in another appeal.

defenses," U.C.C. § 3-305—illegality or fraud in the inducement. *See, e.g., Philadelphia Gear Corp. v. Central Bank*, 717 F.2d 230, 236-38 (5th Cir. 1983); *Voest-Alpine International Corp. v. Chase Manhattan Bank*, 707 F.2d 680, 682 (2d Cir. 1983); *KMW International v. Chase Manhattan Bank*, 606 F.2d 10, 15-16 (2d Cir. 1979); J. White & R. Summers, *supra*, § 18-2 at 711-12. Thus in the instant case the bank must pay whenever the beneficiary, Philadelphia Gear, represents in writing that Orion has not paid invoices outstanding for fifteen days and attaches copies of these invoices. The bank's obligation exists whether or not Orion has legal defenses for nonpayment.

This circuit has previously held under different facts that standby letters of credit represent primary, not secondary, obligations of the issuing bank. *Fidelity Bank v. Lutheran Mutual Life Insurance Co.*, 465 F.2d 211, 213 (10th Cir. 1972); *see also Voest-Alpine International Corp.*, 707 F.2d at 682. We reject the FDIC's argument to the contrary.[3]

[3] "Few arguments have provoked as much concern and deserved it less than the argument that standby letters of credit are unauthorized bank promises that the issuer may repudiate. Virtually all considered authority rejects this argument because (1) the issuance of standby-credits is consistent with traditional banking functions and (2) even if the activity were beyond the authority granted in the bank's charter, most authority holds that neither the bank nor its customer should be able to assert the defense."

J. Dolan, *The Law of Letters of Credit* ¶ 12.03 at 12-12 (1984).

The FDIC's second argument is that the federal deposit insurance fund is structured in a manner that excludes standby letters from the scope of § 1813. Its reasoning is essentially as follows: Congress established explicit guidelines to be applied in determining the amount each member bank should contribute to this insurance fund, *see generally* 12 U.S.C. § 1817 (assessment section); this assessment formula is predicated on individual bank liabilities that would be absolutely due and owing in the event of a bank failure; a bank's liability under a standby letter of credit is necessarily contingent on the bank customer defaulting on its contract with the beneficiary of the standby letter; and Congress never intended the FDIC to attempt to evaluate and assess the risks associated with such contingent liabilities. Therefore, obligations on standby letters are not "deposits" within § 1813.

Section 1817 does establish elaborate guidelines in determining proper assessment amounts for member banks. Subsection 4 addresses the obligation of an insured bank to report its total liability in deposits. In doing so, that section expressly refers to § 1813(*l*) for the definition of "deposit." Section 1813(*l*)(1) includes within the definition of a deposit, "a letter of credit . . . on which the bank is primarily liable." Nowhere does the language of § 1817 support the FDIC's assertion that a standby letter does not represent an absolute liability. We find nothing in the statute or its legislative history narrowing the definition of a deposit to exclude standby letters. *See generally* 1950 U.S. Code Cong. & Ad. News 3765-3779. Federal regulations promulgated pursuant to this section expressly include letters of credit, without differentiating between types, among the several

documents that may be evidence of an insured deposit obligation. *See* 12 C.F.R. § 330.11.[4] As previously discussed, both commercial and standby letters represent primary bank liabilities.

The language including letters of credit on which the bank is primarily liable in the definition of deposit in § 1813 was added in 1960. *See* Pub. L. No. 86-671, 74 Stat. 546 (1960). The purpose for this and accompanying amendments was to simplify the process of determining the assessments paid by banks insured by the FDIC. *See* Sen. Rep. No. 1821, 86th Cong. 2d Sess. *reprinted in* 1960 U.S. Code. Cong. & Ad. News 3234. Nothing in the legislative history that we have found mentions a specific congressional intent for the addition of the references to letters of credit. The absence of any legislative intent to exclude standby letters from the plain language of § 1813 dictates the conclusion that these instruments are within the statutory definition of a "deposit." *See Consumer Product Safety Comm'n v. G.T.E. Sylvania, Inc.*, 447 U.S. 102, 108 (1980) ("Absent a clearly expressed legislative intention to the contrary, [statutory] language must ordinarily be regarded as conclusive."). We therefore affirm the district court's judgment that letters of credit constitute insured deposits.

III

The FDIC argues that plaintiff Philadelphia Gear is not the depositor entitled to recover the deposit

---

[4] "*Deposits evidenced by negotiable instruments.* If any insured deposit obligation of a bank be evidenced by a negotiable certificate of deposit . . . or letter of credit, the owner of such deposit obligation will be recognized for all purposes of claim for insured deposits . . . ."

12 C.F.R. § 330.11.

insurance proceeds. The law provides that the records of the insolvent bank are conclusive as to a claimant's entitlement to deposit insurance. *See* 12 U.S.C. § 1822 (c); 12 C.F.R. § 330.1(b). Philadelphia Gear presented its drafts two and seventeen days after the Comptroller of the Currency declared Penn Square insolvent. Consequently, FDIC argues, at the time of insolvency Philadelphia Gear's claims were unrecorded contingent liabilities, and it cannot rely upon acts performed after the bank's insolvency to entitle it to deposit insurance.

The Ninth Circuit has addressed this issue in *First Empire Bank-New York v. FDIC*, 572 F.2d 1361, 1367-69 (9th Cir.), *cert denied*, 439 U.S. 919 (1978). It held that beneficiaries of standby letters of credit possessed provable claims even though they presented drafts under the letters after the FDIC declared the issuing bank insolvent. In reaching this conclusion the court required three conditions to be met: the claims were in existence prior to insolvency and not dependent on obligations arising after insolvency; total liability was certain when the beneficiaries sued the bank's receiver; and the claims were made in a timely manner, before assets were distributed from the receivership estate. *Id.* We agree with and adopt this approach. The analysis adequately accommodates the FDIC's valid concern of protecting against false claims while permitting legitimate claimants a reasonable time after the determination of insolvency to present their claims to insurance proceeds. Applying this test to the facts before us, Orion's default, at least as to the claims, presented two days after the receiver took over the bank, occurred before Penn Square was declared insolvent; the claims were not dependent upon obligations arising after the insolvency; the claims were absolute and certain in amount and were presented before assets were distributed from the receivership estate. Philadelphia Gear, as beneficiary, is the only party permitted to make a demand on the issuing bank for amounts under the letter of credit; logically it should be considered the depositor in the event the issuing bank becomes insolvent. *Cf.* 12 C.F.R. § 330.11 (transferee of insured deposit obligations evidenced by a letter of credit entitled to claim insurance). We hold that Philadelphia Gear, the beneficiary of the letter of credit, is the "depositor" for purposes of entitlement to the insurance proceeds.

IV

The district court allowed Philadelphia Gear prejudgment interest from the FDIC in its capacity as insurer on the $100,000 deposit insurance proceeds and from the FDIC in its capacity as receiver on the delayed dividend for the excess. The FDIC has not appealed the prejudgment interest ruling on the delayed dividend, but it asserts that the district court erred in granting prejudgment interest on the $100,000.00 insurance proceeds. We agree and hence reverse this part of the court's award.

Absent an express waiver, sovereign immunity bars suit against the United States government or its agencies. By statute, 12 U.S.C. § 1819, the FDIC has the capacity to sue and to be sued. But that does not waive the sovereign immunity doctrine on claims for prejudgment interest. *See Boston Sand and Gravel Co. v. United States*, 278 U.S. 41, 47 (1928); *United States v. Mescalero Apache Tribe*, 518 F.2d 1309, 1316-1319 (Ct. Cl. 1975), *cert. denied*, 425 U.S. 911 (1976). The FDIC insurance statute, 12 U.S.C.

§ 1821(f), permits delays in paying insurance when the FDIC is in doubt about the validity of a claim to insurance proceeds:

> "[T]he Corporation, in its discretion, may require proof of claims to be filed before paying the insured deposits, and that in any case where the Corporation is not satisfied as to the validity of a claim for an insured deposit, it may require the final determination of a court of competent jurisdiction before paying such claim."

Id. Thus, Congress expressly recognized that delays would occur in paying some insurance claims, yet it did not expressly waive its immunity to prejudgment interest. Under those circumstances we must hold that prejudgment interest should not have been awarded on the claims for insurance proceeds.

V

The cross-appeal raises the issue of whether the district court erred in holding that the total value of the letter of credit Penn Square issued was $145,200.00 and not $724,628.50 as Philadelphia Gear contends. When Penr Square issued the original letter of credit on April 23, 1981, its amount was clearly limited to $145,200.00. On May 6, 1981, however, Philadelphia Gear had the letter of credit amended to delete paragraph three and add a new paragraph which reads: "This credit shall be automatically reinstated from time to time for any sum or sums up to $145,000 upon presentation of described documents. This credit and all reinstatements are irrevocable and shall expire on August 1, 1982." The district court found this amendment created an ambiguity concern-

ing the total value of the letter of credit. It explained the ambiguity, as it saw it, as follows:

> "It is unclear whether the parties intended the language 'any sum or sums up to $145,000.00' to be 'any sum or sums up to $145,000.00 *in the aggregate*' or 'any sum or sums up to $145,000.00 *per presentation*.' If it is the former, then the parties merely allowed for multiple, partial drafts totaling up to $145,000.00. But if the parties intended the latter, then the credit is unlimited; the beneficiary Philadelphia Gear could present myriad drafts, each up to $145,000.00."

R. III, 742-43. The district court admitted and considered extrinsic evidence and found that the letter of credit was in fact limited to $145,200.00 in the aggregate.

The FDIC argues that the district court's determination cannot be set aside unless clearly erroneous. Philadelphia Gear argues that the district court's finding in this regard was a legal one and thus is entitled to no deference.

Whether a contractual provision is ambiguous on its face is a legal question. *Southwest Stationery & Bank Supply, Inc. v. Harris Corp.*, 624 F.2d 168, 170 (10th Cir. 1980). Once the court determines that the contract is ambiguous, and resorts to extrinsic testimony or other evidence to ascertain the meaning of the ambiguous terms, its determination of the proper meaning becomes a factual question. *Rockwood & Co. v. Adams*, 486 F.2d 110, 112 (10th Cir. 1973); *Palmer v. Howard*, 493 F.2d 830, 835 (10th Cir. 1974). In that circumstance the district court's interpretation, aided by extrinsic evidence cannot be set aside unless clearly erroneous. *Carpenters & Mill-*

wrights Health Benefit Trust Fund v. Gardineer Dry Walling Co., 573 F.2d 1172, 1173 (10th Cir. 1978).

We agree with the district court that paragraph three is subject to at least two interpretations. Thus, the district court properly considered extrinsic evidence to resolve the ambiguity, and we must find that its conclusion limiting the value to $145,200.00 is clearly erroneous before we may reverse.

Philadelphia Gear argues that the language of the ambiguous paragraph should have been construed against Penn Square, the issuing bank.[5] The district court ruled that the language of a letter of credit, if ambiguous, must be interpreted against the drafting party. Although it did not rely wholly on that rule in resolving the issue, the court found that Philadelphia Gear had requested and drafted the new paragraph and the ambiguity should be resolved against Philadelphia Gear. This court has held that ambiguities in written documents are to be construed against the drafter. *Williams Petroleum Co. v. Midland Cooperatives, Inc.*, 679 F.2d 815, 821 (10th Cir. 1982). The rule is equally applicable to letters of credit. *East Girard Savings Ass'n v. Citizens National Bank & Trust Co.*, 593 F.2d 598, 602 (5th Cir. 1979). The evidence is clear that Philadelphia Gear drafted this

[5] Philadelphia Gear cites four cases to support this proposition. In *Venizelous, S.A. v. Chase Manhattan Bank*, 425 F.2d 461 (2d Cir. 1970), Chase Manhattan Bank, and not the beneficiary, was the author of the relevant amendment that was the subject of the ambiguity. *Id.* at 466. In the other three cases the drafter was also the bank, not the beneficiary. *See Morono Industries Corp. v. Chase Manhattan Bank*, 686 F.2d 112, 115 (2d Cir. 1982); *West Virginia Housing Development Fund v. Sroka*, 415 F. Supp. 1107, 1112 (W.D. Pa. 1976); *Housing Securities, Inc. v. Maine National Bank*, 391 A.2d 311, 319 (Me. 1978).

amendment. Pl. Ex. 1 and 14. Accordingly, we find that the district court properly construed the ambiguous provision against Philadelphia Gear. That it was also the beneficiary of the letter of credit is of no legal significance.

The district court heard two days of testimony, from several witnesses, on the parties' intention with respect to the ambiguous paragraph. We have examined that record evidence and cannot find that the district court erred in limiting the total value of the letter of credit to $145,200.00.

We affirm the judgment of the district court in all respects except for its finding on prejudgment interest. With respect to the prejudgment interest issue we reverse and remand for further proceedings consistent with this opinion.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

No. CIV-82-1191-W

PHILADELPHIA GEAR CORPORATION, PLAINTIFF

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its official capacity as Receiver of Penn Square Bank, N.A., and DEPOSIT INSURANCE NATIONAL BANK OF OKLAHOMA CITY, a national banking association, DEFENDANTS

[Filed Feb. 9, 1984]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Before the Honorable Lee R. West, United States District Judge

This is an action to enforce a standby letter of credit in favor of Philadelphia Gear Corporation ["Philadelphia Gear"] issued by Penn Square Bank, N.A., prior to its insolvency. More specifically, Philadelphia Gear prays for a judgment against the defendant Federal Deposit Insurance Corporation ["FDIC"] in its corporate capacity for one hundred

thousand dollars ($100,000.00) in deposit insurance proceeds and against the FDIC as receiver of the failed Bank for the uninsured balance of six hundred twenty-four thousand seven hundred and twenty-eight dollars and fifty cents ($624,728.50) in the form of a receiver's certificate. The parties initially proffered cross-motions for summary judgment pursuant to Federal Rule of Civil Procedure 56(a) and (b), but on September 13, 1983, the Court denied the motions because there were genuine issues of material fact involving the letter of credit itself. Subsequently, the defendants moved to compel discovery regarding, *inter alia*, the underlying sales contract between Philadelphia Gear and Orion Manufacturing Corporation ["Orion"] pursuant to Federal Rule 37(a), and in response the plaintiff submitted a motion *in limine* seeking to preclude the admission of such evidence at trial. On August 30, 1983, the Court granted these motions in part and denied them in part. In consequence, the only factual issues to be tried involved the letter of credit itself. The numerous, difficult legal issues presented here have been thoroughly and ably briefed by the parties.

This action came on for trial before the Court sitting without a jury on September 20 and 21, 1983. After having heard the evidence presented and the arguments of counsel and after having examined the exhibits, legal memoranda, and proposed findings of fact and conclusions of law, the Court makes the following determination of the parties' rights and liabilities under the disputed letter of credit. Fed. R. Civ. P. 52(a).

Findings of Fact

1. The plaintiff Philadelphia Gear is the beneficiary of an irrevocable standby letter of credit issued by

Penn Square Bank, N.A., on April 23, 1981, and amended on May 6, 1981.

2. The FDIC, an agency of the government of the United States, is a defendant herein in two separate capacities, as receiver and as corporate insurer of deposits. On the one hand, the FDIC was appointed receiver of Penn Square Bank on July 5, 1982, by the Comptroller of the Currency when he declared the Bank insolvent pursuant to 12 U.S.C. §§ 191, 1821(c) (1982); as such, it is fully vested with all assets, claims, and causes of action of the failed Bank and is charged with the duty to wind up its affairs. On the other hand, the FDIC in its corporate capacity is the insurer of deposits in insured banks under 12 U.S.C. § 1821(f). By stipulation on August 17, 1983, it was substituted as a defendant for the Deposit Insurance National Bank of Oklahoma City ["DINB"], which was the new bank chartered exclusively to dispense deposit insurance funds pursuant to 12 U.S.C. §§ 1821(h), (i), and (j).

3. On April 23, 1981, Penn Square Bank issued its irrevocable standby letter of credit 1042 for the account of its customer Orion and in favor of Philadelphia Gear as beneficiary. Plaintiff's Exhibit 1. Letter of credit 1042 was established in the amount of one hundred forty-five thousand two hundred dollars ($145,200.00) and was to expire on August 1, 1982. *Id.* It provided, in relevant part:

> Gentlemen:
>
> We hereby establish our irrevocable letter of credit in your favor available by your drafts drawn at on [sic] Penn Square Bank, N.A. and accompanied by documents specified below:

> (1) Your signed statement that you have invoiced Orion Manufacturing Corporation and that said invoices have remained unpaid for at least fifteen (15) days
>
> (2) Copy of all invoices
>
> (3) All invoices will be verified for authenticity and payment with Orion Manufacturing Corporation.
>
> (4) We hereby agree with drawers, endorsers and bona fide holders of all drafts, drawn under and in compliance with the terms of this credit, that such drafts will be duly honored upon presentation to the drawer.

Id. By its express terms, letter of credit 1042 is subject to the Uniform Customs and Practice for Documentary Credits (International Chamber of Commerce publication no. 290) (1974 rev.). *Id.*

4. Letter of credit 1042 replaced letter of credit 929 issued by Penn Square Bank in the amount of one hundred thousand dollars ($100,000.00), also for the account of Orion and in favor of Philadelphia Gear. Plaintiff's Exhibits 1, 15, 16, 17; Defendants' Exhibits 1, 2.

5. In conjunction with the issuance of letter of credit 1042, Orion on April 23, 1981, executed and delivered to Penn Square Bank an unsecured commercial promissory note in the amount of one hundred forty-five thousand two hundred dollars ($145,000.00) to "back up" the letter of credit. Plaintiff's Exhibits 15, 16, 17. Furthermore, Orion paid to Penn Square Bank an issuance fee or commission in the amount of four hundred and fifty-two dollars ($452.00), which was equal to one percent of the increased value of

letter of credit 1042 above letter of credit 929, *i.e.* forty-five thousand two hundred dollars ($45,200.00). Plaintiff's Exhibits 16, 17.

6. Letter of credit 1042 was amended on May 6, 1981, at the request of Philadelphia Gear to delete paragraph three, which had provided "All invoices will be verified for authenticity and payment with Orion Manufacturing Corporation", and to add a paragraph that provided "This credit shall be automatically reinstated from time to time for any sum or sums up to $145,000.00 upon presentation of described documents. This credit and all reinstatements are irrevocable and shall expire on August 1, 1982." Plaintiff's Exhibit 1 (letter from Bill G. Patterson, Executive Vice President of Penn Square Bank to Mr. Joe Pooler of Philadelphia Gear); Plaintiff's Exhibit 14 (mailgram from Philadelphia Gear to Penn Square Bank).

7. On July 5, 1982, the Comptroller of the Currency of the United States declared Penn Square Bank, N.A., insolvent and appointed the FDIC as its receiver.

8. On July 7, 1982, through its remitting bank, Provident National Bank of Philadelphia, Pennsylvania ["Provident"], Philadelphia Gear presented to the receiver for payment three complying drafts on letter of credit 1042 in the total amount of two hundred forty-two thousand three hundred and seventy dollars ($242,370.00). Plaintiff's Exhibits 5a, 5b, 5c.

9. By July 16, 1982, neither Philadelphia Gear nor Provident had received notice from either the receiver or DINB regarding the July 7, 1982, drafts. Therefore, on July 16, 1982, Provident sent a telex to Robert Williams, letter of credit manager; James

Hudson, FDIC liquidator; and Albert Thompson, Esq., urgently requesting advice of the disposition of the July 7, 1982, drafts. Plaintiff's Exhibit 6.

10. On July 22, 1982, again through Provident as its remitting bank, Philadelphia Gear presented to the receiver for payment five additional complying drafts on letter of credit 1042 in the total amount of four hundred eighty-two thousand three hundred fifty-eight dollars and fifty cents ($482,358.50). Plaintiff's Exhibits 8a-e.

11. On or about July 26, 1982, Philadelphia Gear received a letter dated July 21, 1982, from James P. Hudson, Liquidator, formally giving notice that the received disaffirmed "any and all" obligations under letter of credit 1042 and that it would not honor any drafts thereon. Plaintiff's Exhibit 7.

12. On or about July 28, 1982, Philadelphia Gear received five return item notices dated July 23, 1982, indicating that the five drafts of July 22, 1982, were being returned unpaid due to the insolvency of Penn Square Bank. Plaintiff's Exhibit 11.

13. On or about August 2, 1982, Philadelphia Gear received three return item notices, indicating that the three drafts of July 7, 1982, were also being returned unpaid due to the insolvency of Penn Square Bank. Plaintiff's Exhibit 10.

Conclusions of Law

I.

1. The Court has subject matter jurisdiction under 28 U.S.C. § 1331(a), as this action arises at least in part under the Federal Deposit Insurance Act, 12 U.S.C. §§ 1811-1832 (1982). In addition, the Court has subject matter jurisdiction pursuant to Section

9 (fourth) of the Federal Deposit Insurance Act, 12 U.S.C. § 1819 (fourth), because the FDIC is being sued here both in its corporate capacity and in its capacity as receiver of a failed national bank and because such suits are deemed to arise under federal law. *See Federal Deposit Insuranc Corp. v. Huntington Towers, Ltd.*, 443 F. Supp. 316, 318 (E.D.N.Y. 1977). *But cf. Federal Deposit Insurance Corp. v. Sumner Financial Corp.*, 602 F.2d 670, 683 (5th Cir. 1979) (no federal subject matter jurisdiction in a suit brought against the FDIC as receiver of a failed state bank).

2. Venue is proper in this District. 12 U.S.C. § 94 (1976); 28 U.S.C. § 1391 (1976). *See In re Longhorn Securities Litigation*, 573 F.Supp. 274 (W.D. Okla. 1983).

3. The applicable substantive law is derived from several sources, depending on the particular claim or defense at issue. Of course, to the extent that a claim or defense arises under the Constitution, laws, or treaties of the United States, federal law governs. *E.g., Deitrick v. Greaney*, 309 U.S. 190, 200-201 (1940); 28 U.S.C. § 1652. And in cases to which the FDIC is a party, federal common law applies if the statute itself does not provide the rule of decision. *D'Oench, Duhme & Co. v. Federal Deposit Insurance Corp.*, 315 U.S. 447, 456-59 (1941) (per Douglas, J.), 465-75 (Jackson, J., concurring). *See generally* P. Bator, P. Mishkin, D. Shapiro & H. Wechsler, *Hart and Wechsler's The Federal Courts and the Federal System* 762-70 (2d ed. 1973). However, an important source of federal common law, especially in a commercial context, is the state law under which the disputed legal relationships arose. *See D'Oench, Duhme, supra*, 315 U.S. at 474 (Jackson, J., concurring); *Federal Deposit Insurance Corp. v. Bank*

of America National Trust & Savings Association, 701 F.2d 831, 834-35 (9th Cir. 1983). *Accord United States v. Kimbell Foods*, 440 U.S. 715, 726-27, 729 (1979) (state law, incorporated as part of federal common law, determines the priority of federal Small Business Administration lien). Clearly, there is no federal law governing in general the rights and duties under a letter of credit. Instead, the parties to letter of credit 1042 expressly agreed to the application of the Uniform Customs and Practice For Documentary Credits (International Chamber of Commerce publication no. 290) (1974 rev.) ["UCP"], and that agreement is binding. 12A Okla. Stat. 1-105(1) (1981). *See Restatement (Second) of Conflict of Laws* § 187 (1971). Furthermore, Article V of the Uniform Commercial Code ["UCC"] generally supplements the UCP in domestic transactions. *See* J. White & R. Summers, *Handbook of the Law under the Uniform Commercial Code* § 18-3 at 611 (1972). Because the state with the most significant relationship to the transaction is Oklahoma, hers is the relevant state law. *See Restatement (Second) of Conflict of Laws, supra*, § 188.

II.

4. The rules of interpretation that govern written contracts generally also govern letters of credit. *Bank of North Carolina, N.A. v. Rock Island Bank*, 570 F.2d 202, 207 (7th Cir. 1978); *Venizelos, S.A. v. Chase Manhattan Bank*, 425 F.2d 461, 465-66 (2d Cir. 1970). *See* 15 Okla. Stat. § 151 (1981). *See generally* 3 R. Anderson, *Uniform Commercial Code* § 5-101:9 (1971).

5. The general rule is that a contract must be interpreted to give effect to the mutual intention of the parties at the time of contracting. 15 Okla. Stat.

§ 152. And the intent of the parties is to be drawn from the language of the contract itself, if it is clear and explicit and is not absurd. 15 Okla. Stat. §§ 154, 155.

6. The Court has previously determined that letter of credit 1042 is ambiguous. Order 4-5 (Sept. 13, 1983) (denying cross-motions for summary judgment). When letter of credit 1042 was initially issued on April 23, 1981, its amount was clearly limited to "One Hundred Forty-Five Thousand Two Hundred and No/100 Dollars $145,200.00". Plaintiff's Exhibit 1. However, the May 6, 1981, amendment to the letter of credit added a new paragraph four that provided "[t]his credit shall be automatically reinstated from time to time for any sum or sums up to $145,000.00 upon presentation of described documents. . . ." Plaintiff's Exhibits 1 & 14. It is unclear whether the parties intended the language "any sum or sums up to $145,000.00" to be "any sum or sums up to $145,000.00 *in the aggregate*" or "any sum or sums up to $145,000.00 *per presentation*". If it is the former, then the parties merely allowed for multiple, partial drafts totaling up to $145,000.00. But if the parties intended the latter, then the credit is unlimited; the beneficiary Philadelphia Gear could present myriad drafts, each up to $145,000.00.

7. When a written contract is ambiguous, as here, the Court must apply accepted rules of construction and admit parol and extrinsic evidence to determine the parties' intent. 15 Okla. Stat. § 153.

8. The Court concludes, as a matter of law, that letter of credit 1042 is limited in the aggregate to one hundred forty-five thousand and two hundred dollars ($145,200.00).

First, "a reasonable construction is preferred to one which is unreasonable, and where the language is contradictory, obscure, or ambiguous and susceptible of two constructions, it will be interpreted in a fair and rational sense, rather than in a manner which would make the contract unusual, inequitable, or such that reasonable men would be unlikely to enter into." *Mortgage Clearing Corp. v. Baughman Lumber Co.*, 435 P.2d 135, 139 (Okla. 1967) (citations omitted); 15 Okla. Stat. §§ 154, 159. Here, to hold that letter of credit 1042 is revolving and unlimited would create an obligation that reasonable people would not likely enter into, for it could subject the Bank to virtually limitless liability and cause it to violate its legal lending limit as provided in 12 U.S.C. § 84(a) (1982) and 12 C.F.R. § 7.1160 (1983).

Second, assuming *arguendo* that the first rule does not resolve the interpretation issue, another rule leads ineluctably to the same conclusion. The language of a letter of credit, if ambiguous, must be interpreted against the party that drafted it. *East Girard Savings Association v. Citizens National Bank and Trust Co. of Baytown*, 593 F.2d 598, 602 (5th Cir. 1979); *Bank of North Carolina*, *supra*, 570 F.2d at 207; *Venizelos, S.A.*, *supra*, 425 F.2d at 466. *See King-Stevenson Gas & Oil Co. v. Texan Oil Corp.*, 466 P.2d 950, 954 (Okla. 1970); 15 Okla. Stat. § 170. In the case at bar, Philadelphia Gear requested and indeed drafted the language in paragraph four of the amended letter of credit, Plaintiff's Exhibits 1 & 14, so the ambiguity in that language must be resolved against it.

Moreover, this holding is buttressed by substantial extrinsic evidence. One, Orion's back-up promissory note is only for $145,200.00. Plaintiff's Exhibits 15-

17; Finding of Fact 5, *supra*. Two, Orion was only charged $452.00 for the Bank's commission on the letter of credit, which was equal to one percent of the increase in its face value over letter of credit 929. Plaintiff's Exhibits 16, 17; Finding of Fact 5, *supra*. Although these events occurred in connection with the initial issuance of the letter of credit on April 23, 1981, instead of the amendment of May 6, 1981, the evidence clearly has probative value.

At trial, Philadelphia Gear brought on Mr. Jerry Fain, an expert witness in the area of letters of credit. *See* Plaintiff's Exhibit 2. Mr. Fain testified that letter of credit 1042 revolves around value, *i.e.*, that it is automatically reinstated in the amount of $145,000.00 upon the presentation of a draft or demand, *see* Plaintiff's Exhibit 3 at 29, and that it is, on its face, unlimited. However, the Court is not persuaded. Mr. Fain's testimony is undercut both by the roles of interpretation, above, and by one of the documents on which he relies in his testimony and his trade, the Guide to Documentary Credit Operations (International Chamber of Commerce publication no. 305) (1978), which indicates that letters of credit that revolve around value are not in common use because of their "incalculable liability". Plaintiff's Exhibit 3 at 29.

III.

9. An irrevocable letter of credit upon its issuance represents an absolute, primary obligation owed by the issuing bank to the beneficiary. *See Fidelity Bank v. Lutheran Mutual Life Insurance Co.*, 465 F.2d 211, 213 (10th Cir. 1972); *Dulien Steel Products, Inc. of Washington v. Bankers Trust Co.*, 189 F.Supp. 922, 927 (S.D.N.Y. 1960); *aff'd*, 298 F.2d 836 (2d Cir. 1962). *See also* 12A Okla. Stat. § 5-106(2).

10. An issuing bank must honor a draft or demand for payment that complies with the terms and conditions of a letter of credit, without reference to the underlying contract between its customer and the beneficiary. *KMW International v. Chase Manhattan Bank, N.A.*, 606 F.2d 10, 10-16 (2d Cir. 1979); *East Girard Savings Association, supra*, 593 F.2d at 602; *Chase Manhattan Bank, N.A. v. Equibank, N.A.*, 550 F.2d 882, 884-85 (3d Cir. 1977); *UCP, supra*, general provisions and definitions c, art. 3a, 8a, 8c; 12A Okla. Stat. § 5-114(1). *See* 3 R. Anderson, *supra*, §§ 5-114:1, 7. *See generally* Harfield, *Enjoining Letter of Credit Transactions*, 95 Bus. L. J. 596, 598-99 (1978).

11. If, upon the receipt of the documents accompanying a draft or demand, the issuing bank determines that they appear on their face not to comply with the terms and conditions of the letter of credit, it must without delay notify the bank from which the documents were received of its determination and the reasons therefor. UCP, *supra*, art. 8c-e. Further, such notice must state either that the issuing bank is holding the documents at the disposal of the presenter or that they are being returned to it. *Id.* art. 8e.

12. An issuing bank's failure to honor a draft or demand within three banking days of receipt of the documents constitutes dishonor of the draft or demand and of the letter of credit. 12A Okla. Stat. § 5-112 (1).

13. Here, Philadelphia Gear's drafts did in fact comply with the terms and conditions of letter of credit 1042. *Compare* Plaintiff's Exhibit 1 *with* Plaintiff's Exhibits 5a-c, 8a-e.

14. Moreover, by failing to give notice of non-compliance in the form and manner prescribed in the UCP, the FDIC is estopped from claiming that the drafts did not comply. UCP, *supra*, art. 8f. *Accord Barclays Bank D.C.O. v. Mercantile National Bank*, 481 F.2d 1224, 1237 (5th Cir. 1973), *cert. dismissed*, 414 U.S. 1139 (1974) (waiver and estoppel applicable under article V of the UCC).

15. Therefore, *prima facie*, Philadelphia Gear is entitled to damages for wrongful dishonor. *See* 12A Okla. Stat. 5-115(1).

IV.

The FDIC interposes four defenses: that letter of credit 1042 does not give rise to a provable claim; that it is an executory contract which the receiver properly disaffirmed; that the plaintiff failed to mitigate its damages; and that, if the letter of credit is unlimited in amount, it constitutes an unenforceable, *ultra vires* act on the part of Penn Square Bank. Because the Court concludes herein that the letter of credit is limited, there is no need to reach the FDIC's *ultra vires* defense. The others are addressed in turn.

16. The plaintiff does have a provable claim. *See First Empire Bank-New York v. Federal Deposit Insurance Corp.*, 572 F.2d 1361, 1369 (9th Cir. 1978), *cert. denied*, 439 U.S. 919 (1978); *Federal Deposit Insurance Corp. v. Freudenfeld*, 492 F.2d 763 (E.D. Wisc. 1980). *Cf. Federal Deposit Insurance Corp. v. United States National Bank*, 685 F.2d 270 (9th Cir. 1982) (claim for rescission of subordinated capital notes on the basis of fraud held to be provable).

The general rule is that, to be provable, a claim must be determinable as of the date of the bank's insolvency. *See American Surety Co. v. Bethlehem*

Bank, 314 U.S. 314, 317-18 (1941) (citing *Merrill v. National Bank of Jacksonville*, 173 U.S. 131, 143 (1898)). This rule follows from the command of the National Bank Act that distributions from the estate of an insolvent national bank shall be made ratably, 12 U.S.C. § 194, and that any preferential distribution is null and void, 12 U.S.C. § 91. *See American Surety Co., supra*, 314 U.S. at 317-18.

Only one federal appellate court has addressed the specific issue presented here. In *First Empire Bank-New York v. Federal Deposit Insurance Corp.*, 572 F.2d 1361, 1367-69 (9th Cir. 1978), *cert. denied*, 439 U.S. 919 (1978), a panel of the Ninth Circuit held that the beneficiaries of certain letters of credit issued by the United States National Bank prior to its insolvency did have provable claims, even though they did not draft on those letters until after the bank's failure. *Id.* at 1369. This Court has closely analyzed the decision in *First Empire* and adopts it as authoritative. *Accord Freudenfeld, supra*, 492 F.Supp. at 768, 770.

The test of provability articulated by the Ninth Circuit has three elements. The claims must be in existence before insolvency and must not depend on any new contractual obligations arising later. The liability on the claims must be absolute and certain when suit is filed against the bank's receiver. And the claims must be made in a timely manner, before any distribution of assets from the receivership estate. *See First Empire, supra*, at 572 F.2d 1367-69. *See also Federal Deposit Insurance Corp. v. United States National Bank, supra*, 685 F.2d at 276 (applying the *First Empire* test to claims involving subordinated capital notes).

Here, as in *First Empire*, the plaintiff-beneficiary does have a provable claim. First, as the Ninth Circuit concluded, because the letter of credit was issued prior to the bank's failure, it does not depend upon any new contractual obligations arising after insolvency. *First Empire*, *supra*, 572 F.2d at 1367. Thus, the cases on which the FDIC relies involving claims for liquidated damages for future rent, *e.g.*, *Federal Deposit Insurance Corp. v. Grella*, 553 F.2d 262 (2d Cir. 1977); *Kennedy v. Boston-Continental National Bank*, 84 F.2d 592 (1st Cir. 1936), *cert. dismissed*, 300 U.S. 684 (1937), are plainly inapposite. *First Empire*, *supra*, 572 F.2d at 1367. Second, the plaintiff's claim here was absolute and certain at the time it was filed; that claim was and is for $100,000.00 in deposit insurance and the balance of $624,728.50 in a receiver's certificate. Complaint, demand for relief no. 2 (Aug. 4, 1982). Third and finally, the plaintiff's claim was timely made well before any distributions from the insolvent Bank's estate. The Bank failed on July 5, 1982; the plaintiff's first drafts were presented on July 7, 1982; its final drafts were presented on July 22, 1982; and this action was instituted on August 4, 1982.

17. Letter of credit 1042 is not an executory contract subject to the receiver's disaffirmance.

As indicated above, Conclusion of Law 9, *supra*, upon its issuance a standby letter of credit represents an absolute, primary obligation of the issuing bank to the beneficiary. It is this independent engagement of the credit and solidity of the issuing bank that gives letters of credit their commercial utility. Therefore, to hold otherwise would thwart justifiable, good faith expectations.

Moreover, this holding is in accord with the regulations developed by the Comptroller of the Currency. Interpretive Ruling 7.1160, now codified at 12 C.F.R. § 7.1160 (1983), provides that standby letters of credit are subject to the lending limit of 12 U.S.C. § 84 and must be combined with all other nonexcepted loans to the account party in applying section 84 unless the credits are backed by an amount equal to the bank's maximum liability or unless the Comptroller determines that that particular class of standby letters of credit "will not expose the issuer to the similar risk of loss as would a loan to the account party." 12 C.F.R. § 7.1160(b), (c). Thus, it is clear that the banking regulators themselves consider standby letters of credit to be direct, primary obligations, not unlike outright loans to account parties. Such an interpretation also finds support in legal literature. *See* Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716, 720, 735 (1973).

In support of its position that the letter of credit is an executory contract subject to disaffirmance, the FDIC relies on the "general rule" as stated in 2 R. Clark, *A Treatise on the Law and Practice of Receivers* § 409 (3d ed. 1959), and on the Bankruptcy Reform Act rule, 11 U.S.C. § 365(a). That reliance, however, is unavailing. First, the Bankruptcy Reform Act does not apply to banks. *Corbin v. Federal Reserve Bank of New York*, 629 F.2d 233, 236 (2d Cir. 1980), *cert. denied*, 450 U.S. 970 (1981); 11 U.S.C. § 109(b). Second, Clark is not dispositive, and the FDIC has not cited any federal case on point. Indeed, in *Freudenfeld* the court rejected the FDIC's argument, albeit without analysis. *Freudenfeld*, *supra*, 492 F.Supp. at 769.

18. The plaintiff-beneficiary Philadelphia Gear is not required to mitigate its damages resulting from the FDIC's wrongful dishonor. *See Bank of North Carolina, N.A. v. Rock Island Bank*, 630 F.2d 1243, 1254 (7th Cir. 1980).

The UCP and the UCC do not expressly impose on a beneficiary a duty to mitigate, *see Beckman Cotton Co. v. First National Bank*, 666 F.2d 181, 184 (5th Cir. 1982) (section 5-115(1) of the UCC "does not expressly impose or negate a duty to mitigate"); J. White & R. Summers, *supra*, § 18-6 at 627-28; 3 R. Anderson, *supra*, § 5-115:4, and their spirit and letter militate against the creation of such a duty. Primarily, it is axiomatic that a letter of credit is independent from the sales contract that underlies it. Conclusion of Law 10, *supra*. To impose a duty to mitigate would violate the independence principle and diminish the commercial utility of letters of credit. Additionally, the language of the UCC appears to cut against such a duty. Under the UCC, when an issuing bank wrongfully dishonors a draft on a letter of credit, the beneficiary has "the rights of a person in the position of a seller" under Section 2-707, including the right to mitigate under Section 2-706(1). 12A Okla. Stat. §§ 5-115(1), 2-707. However, a right is not a duty, and the plaintiff here has simply elected not to exercise that right. This conclusion is supported by the final sentence of Section 5-115(1), which provides that "[*i*]*n the event no resale or other utilization is made* the documents, goods or other subject matter involved in the transaction must be turned over to the issuer on payment of judgment." 12A Okla. Stat. § 5-115(1) (emphasis added).

IV.

19. Letter of credit 1042 is an insured deposit under Section 3 of the Federal Deposit Insurance Act, 12 U.S.C. § 1813(m).

As with all issues of statutory construction, the Court's inquiry must begin with the statute itself. If the language of the statute is unambiguous, it is conclusive absent a "clearly expressed legislative intent to the contrary." *Consumer Products Safety Commission v. Sylvania, Inc.*, 447 U.S. 102, 108 (1980). *See generally* 2A C. Sands, *Sutherland on Statutory Construction* § 46.01 (4th ed. 1973) (plain meaning rule).

In the instant case there are two plausible statutory bases upon which the Court could conclude that the letter of credit is a deposit under section 3(*l*) of the Act, 12 U.S.C. § 1813(*l*), and thus an insured deposit under section 3(m), 12 U.S.C. § 1813(m). This does not imply, however, that the plaintiff is entitled to a double recovery, for the two alternative bases are mutually exclusive. *See Federal Deposit Insurance Corp. v. Irving Trust Co.*, 137 F.Supp. 145, 162-63 (S.D.N.Y. 1955). First, Section 3(*l*)(1) in pertinent part defines "deposit" as:

> the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and . . . which is evidenced by . . . a letter of credit . . . on which the bank is primarily liable: *Provided*, That, without limiting the generality of the term "money or its equivalent", any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issues in exchange for . . . a promissory note upon which the person

> obtaining any such credit or instrument is primarily or secondarily liable . . .

Federal Deposit Insurance Act, § 3(*l*)(1), 12 U.S.C. § 1813(*l*)(1). Second, Section 3(*l*)(3) in pertinent part defines "deposit" as:

> money received or held by a bank, or the credit given for money or its equivalent received or held by a bank, in the usual course of business for a special or specific purpose, regardless of the legal relationship thereby established, including without being limited to . . . funds held to meet its acceptances or letters of credit . . .

Federal Deposit Insurance Act, § 3(*l*)(3), 12 U.S.C. § 1813(*l*)(3).

20. Letter of credit 1042 is a deposit under Section 3(*l*)(1), 12 U.S.C. § 1813(*l*)(1).

There are essentially two parts to the definition in Section 3(*l*)(1): one, the thing of value with which the bank's customer has parted and, two, the account or instrument for which the bank has received or held that thing of value. With regard to the first part of that definition, a deposit is "the unpaid balance of money or its equivalent received or held by a bank in the usual course of business . . ." But the proviso to Section 3(*l*)(1) clearly requires an account or instrument to be *considered* as evidencing the receipt of the equivalent of money when issued in exchange for, *inter alia*, "a promissiory note upon which the person obtaining . . . such . . . instrument is primarily or secondarily liable . . ." With regard to the second part of that definition, a deposit is that for which a bank is obligated to give credit to an account or, *inter alia*, "which is evidenced by . . . a

letter or credit . . . on which the bank is primarily liable . . ."

Furthermore, nothing in the legislative history suggests that Congress intended anything other than that which appears from the plain language of Section 3(*l*)(1). The original definition of "deposit" was quite narrow, but the FDIC was authorized to expand that definition by regulation to comport with general usage. *See* Banking Act of 1935, Pub. L. No. 305, 49 Stat. 684, 685-86 (1935). The FDIC subsequently promulgated Regulation I, which defined "deposit" as, *inter alia*, "letters of credit on which the bank is primarily liable issued under either of the following circumstances: (1) For money or its equivalent received by the issuing bank; or (2) For a charge against a depcsit account in the issuing bank . . ."; however, Regulation I further provided in relevant part that *"letters of credit must be regarded as issued for the equivalent of money when issued in exchange for . . . promissory notes upon which the person procuring [the credit] is primarily or secondarily liable."* Regulation I(c), (d) 12 C.F.R. § 301.1(c), (d) (1939) (emphasis added), *reprinted in Federal Deposit Insurance Corp. v. Irving Trust Co., supra*, 137 F.Supp. at 147-48. This definition was incorporated into the Federal Deposit Insurance Act as part of a set of amendments to simplify the method of determining insurance assessments; significantly, the proviso to the definition was adopted virtually unchanged. *See* H.R. Rep. No. 1827, 86th Cong., 2d Sess. 1-6 (1960); S. Rep. No. 1821, 86th Cong., 2d Sess. (1960), *reprinted in* 1960 *U.S. Code Cong. & Ad. News* 3234, 3239-40, 3243. That legislation, enacted as Public Law 86-671, 74 Stat. 546 (1960), was passed in the Senate without comment, 106 Cong. Rec. 15622 (1960), and in the House of

Representatives with minimal debate, none of which focused on the definitional section, 106 Cong. Rec. 14794-800 (1960). Likewise, the House and Senate committee reports are unenlightening. *See* H.R. Rep. No. 1827, *supra*; S. Rep. No. 1821, *supra*.

In the case at bar, letter of credit 1042 satisfies both *parts* of the Section 3(*l*)(1) definition. First, although the letter of credit was not issued in exchange for legal tender, it must be *considered* as having been issued in exchange for "money or its equivalent" because it was issued in exchange for Orion's promissory note. 12 U.S.C. § 1813(*l*)(1). Second, the letter of credit itself is one on which the bank is primarily liable. Conclusion of Law 9, *supra*.

The FDIC's arguments to the contrary are not convincing. The FDIC first attempts to distinguish Orion's promissory note from that which is within the compass of statutory definition by arguing that the note was merely a conditional debt, contingent on the letter's being called; that it was not a liability of Orion until that time; and that Penn Square Bank never considered it an asset. These arguments may be interesting, but they ignore the plain terms of the statute: "[A]ny instrument *must be regarded* as evidencing the receipt of the equivalent of money when credited or issued in exchange for . . . a promissory note upon which the person obtaining . . . such credit or instrument is primarily or secondarily liable . . ." Federal Deposit Insurance Act, § 3(*l*)(1), 12 U.S.C. § 1813(*l*)(1). The FDIC then argues that letter of credit 1042 is not one on which the bank is primarily liable, because it is a standby letter of credit and, as such, because it is only effective after the account party has defaulted. This argument is without merit. A standby letter of credit is not a guaranty or surety contract. *Federal Deposit Insurance Corp. v. Freudenfeld*, *supra*, 492 F.Supp. at 767-68; *Prudential Insurance Co. v. Marquette National Bank of Minneapolis*, 419 F.Supp. 734, 735-36 (D. Minn. 1976). Rather, a standby letter of credit is a direct, primary engagement of the issuing bank's credit, independent of the underlying transaction. Conclusion of Law 9, *supra*.

21. Letter of credit 1042 is not a deposit under Section 3(*l*)(3), 12 U.S.C. § 1813(*l*)(3).

Section 3(*l*)(3) defines "deposit" as "money held or received by a bank, or the credit given for money or its equivalent received or held by a bank . . . regardless of the legal relationship thereby established, including without being limited to . . . funds held to meet its . . . letters of credit . . ." It is abundantly clear that Section 3(*l*)(3) is limited to special purpose funds. *See generally Federal Deposit Insurance Corp. v. Irving Trust Co.*, *supra*, 137 F.Supp. at 149-51, 156-61.

The plaintiff contends that the phrase "or the credit given" embraces not only a fund, but also the letter of credit for which that fund serves as collateral. This contention is unconvincing. The structure of Section 3 reveals Congress' intent to treat letters of credit for which no cash collateral is offered differently from those for which it is; Section 3(*l*)(1) encompasses the former, and Section 3(*l*)(3) encompasses the latter. Either a letter of credit itself is a deposit (assuming that the other requirements of Section 3(*l*)(1) are met), or any funds set aside to secure it are (under Section 3(*l*)(3)); it cannot at once be both. *See Irving Trust Co.*, *supra*, 137 F. Supp. at 162-63. This conclusion is consistent with the language of Section 3(*l*)(3), which defines a deposit as, *inter alia*, "*funds held* to meet its acceptances or letters of credit . . ."

22. The status of letter of credit 1042 as an insured deposit is not affected either by the failure to Penn Square to pay insurance assessments on it under 12 U.S.C. § 1817(c)(1) or by the failure of the Federal Deposit Insurance Corporation to require such payment pursuant to 12 U.S.C. § 1817(c)(4). *See Federal Deposit Insurance Corp. v. Records*, 34 F.Supp. 600 (W.D. Mo. 1940); *Jones v. Federal Deposit Insurance Corp.*, 24 F.Supp. 985 (W.D. Okla. 1938). *Accord Hockenjos v. Federal Deposit Insurance Corp.*, 199 A. 596 (N.J. 1938).

23. Philadelphia Gear, as beneficiary of letter of credit 1042, is the owner of the deposit obligation and is thus entitled to the deposit insurance proceeds therefor.

As a general principle, the records of a failed bank are conclusive as to the existence of any claim for deposit insurance. 12 C.F.R. § 330.1(b)(1) (1983). In the case at bar, letter of credit 1042 was issued in favor of Philadelphia Gear as named beneficiary and for the account of Orion. Plaintiffs Exhibit 1. There is no evidence that the credit was transferred, assigned or negotiated to a third party, so 12 C.F.R. § 330.11 is not implicated. Therefore, the only issue is whether the deposit obligation is owned by Philadelphia Gear or Orion. *See Irving Trust Co., supra*, 137 F.Supp. at 157.

Section 5-117 of the Oklahoma Commercial Code is a valuable guide in resolving this issue, although it is not fully on point because letter of credit 1042 was not secured by a fund. 12A Okla. Stat. § 5-117. *See* 12 C.F.R. § 330.1(a) (1983). Section 5-117 provides for the disposition of the proceeds of a letter of credit upon the insolvency of the issuing bank. If a proper draft or demand is made on a credit, the beneficiary is entitled to payment from the fund se-

curing the credit in preference over depositors or other general creditors of the issuing bank, 12A Okla. Stat. § 5-117(1)(a), but if the credit expires or if the beneficiary surrenders its rights under the credit, then the person who provided that fund or collateral is entitled to its return, *id.* § 5-117(1)(b). Here, Philadelphia Gear as beneficiary has presented complying drafts on the credit, so it is entitled to the deposit insurance therefor.

24. The plaintiff is entitled to interest from the FDIC in its corporate capacity on the deposit insurance funds from the date of the maturity of the credit, and the plaintiff is further entitled to interest from the FDIC as receiver on the dividend it should have received during the first distribution from the estate of the failed bank. *See Ticonic National Bank v. Sprague*, 303 U.S. 406, 411 (1938); *Armstrong v. American Exchange National Bank*, 133 U.S. 433, 470 (1890); *First Empire Bank—New York v. Federal Deposit Insurance Corp.*, 634 F.2d 1222, 1224-25 (9th Cir. 1980); *First Empire Bank—New York v. Federal Deposit Insurance Corp.*, 572 F.2d 1361, 1372 (9th Cir. 1978), *cert. denied*, 439 U.S. 919 (1978); *Anderson v. General American Life Insurance Co.*, 141 F.2d 898, 909 (6th Cir. 1944).

25. Finally, the FDIC is entitled to the goods involved in the underlying transaction with Orion (at least up to the total amount of judgment, *i.e.*, $145,200.00). 12A Okla. Stat. § 5-115(1).

IT IS SO ORDERED this 8th day of February, 1984.

/s/ Lee R. West
LEE R. WEST
United States District Judge

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

No. CIV-82-1191-W

PHILADELPHIA GEAR CORPORATION, PLAINTIFF

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its official capacity as Receiver of Penn Square Bank, N.A., and DEPOSIT INSURANCE NATIONAL BANK OF OKLAHOMA CITY, a national banking association, DEFENDANTS

[Filed Feb. 9, 1984]

JUDGMENT

In accordance with this Court's Findings of Fact and Conclusions of Law filed this day, judgment is hereby entered in favor of the plaintiff Philadelphia Gear Corporation against the defendant Federal Deposit Insurance Corporation in its corporate capacity for one hundred thousand dollars ($100,000.00) in deposit insurance and against the FDIC in its capacity as receiver for the balance of forty-five thousand two hundred dollars ($45,200.00) in the form of a receiver's certificate. Furthermore, the plaintiff

is entitled to interest, one, from the FDIC in its corporate capacity from the date of maturity of the credit, and, two, from the FDIC as receiver from the date of the first distribution from the estate of the failed bank. Finally, the plaintiff shall release to the FDIC the goods involved in the underlying transaction with Orion (at least up to a value of $145,200.00).

DATED this 8th day of February, 1984.

/s/ Lee R. West
LEE R. WEST
United States District Judge

APPENDIX D

JANUARY TERM—February 19, 1985

Before Honorable James E. Barrett, Honorable Robert H. McWilliams, Honorable William E. Doyle, Honorable Monroe G. McKay, Honorable James K. Logan, Circuit Judges

---

Nos. 84-1901, 84-2007

PHILADELPHIA GEAR CORPORATION,
PLAINTIFF-APPELLANT, CROSS-APPELLEE

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, ETC.,
ET AL., DEFENDANTS-APPELLEES, CROSS-APPELLANTS

This matter comes on for consideration of the petition for rehearing and suggestion for rehearing en banc filed by appellee/cross appellant, Federal Deposit Insurance Corporation, in the captioned cause.

Upon consideration whereof, the petition for rehearing is denied by the panel that rendered the decision sought to be reheard.

The petition for rehearing having been denied by the panel to whom the case was argued and submitted, and no member of the panel nor judge in regular active service on the Court having requested that the Court be polled on rehearing en banc, Rule 35, Federal Rules of Appellate Procedure, the suggestion for rehearing en banc is denied. Judge William J. Holloway, Jr., and Judge Stephanie K. Seymour did not participate.

/s/ Howard K. Phillips
HOWARD K. PHILLIPS, Clerk

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OPPOSITION

BRIEF

Supreme Court, U.S.
FILED
SEP 24 1985
JOSEPH F. SPANIOL, JR.
CLERK

NO. 84-1972

In the Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

Versus

PHILADELPHIA GEAR CORPORATION,
Respondent

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

Whether a standby letter of credit issued in exchange for a promissory note from the issuing bank's customer is a deposit within the meaning of 12 U.S.C. §1813(*l*)(1).

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IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1984

No. 84-1972

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

Versus

PHILADELPHIA GEAR CORPORATION,
Respondent

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

SUMMARY OF ARGUMENT

This case presents a simple question of statutory construction, on which the district court and court of appeals agreed. There is no indication in either the legislative history of 12 U.S.C. § 1813(*l*)(1) or the administrative interpretations of the Federal Deposit Insurance Corporation (hereinafter, "the FDIC") that any departure from the clear statutory language is warranted. Respondent's letter of credit, on which the issuing bank was primarily liable, was issued for a promissory note that must be regarded as the equivalent of money for the purposes of federal deposit insurance.

The factors to which the Court traditionally looks to determine whether to grant a writ of certiorari are not present here. There is no dispute among federal courts of appeals on the issue faced by the courts below, and not only are the supposed effects of the ruling not as great as the FDIC suggests, but the FDIC has already introduced legislation in Congress to ameliorate them.

ARGUMENT

1. *The Decision Below Was a Correct Application of 12 U.S.C. § 1813(1)(1) to the Facts of the Case.*

The term "deposit" is defined in 12 U.S.C. § 1813(*l*)(1), which provides, in pertinent part, that a letter of credit is:

> ". . .the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and. . . which is evidenced by. . . a letter of credit. . . on which the bank is primarily liable: *Provided*, that, without limiting the generality of the term 'money or its equivalent', any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for . . . a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable. . . ."

Analysis of respondent's entitlement to federal deposit insurance begins with an examination of the statute itself. If unambiguous, the statute's language is conclusive absent "a clearly expressed legislative intent to the contrary." *Consumer Products Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980). The question

raised by the FDIC's petition for a writ of certiorari, simply, is whether the language of Section 1813 is clear and unambiguous. Bare statutory construction establishes beyond question that respondent's letter of credit fits squarely within the definition of insured deposits in Section 1813(*l*)(1). Resort to methods of construing ambiguous statutes, such as legislative history and administrative interpretations, therefore is not needed. A passage from the *Chevron U.S.A., Inc.* case not quoted by the FDIC in its brief makes this clear:

> First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.

Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., ___U.S. ___, 104 S. Ct. 2778, 2781-82 (1984); *see Caminetti v. United States*, 242 U.S. 470, 485 (1917).

(a) The interpretation advanced by the FDIC at this stage of the case is entitled to no special deference.

In its brief in support of its petition for a writ of certiorari (hereinafter, "FDIC Brief"), the FDIC states that, notwithstanding the plain terms of the statute, it has simply "informally [*i.e.*, without issuing a regulation on the matter] but consistently" elected not to treat "unfunded" standby letters of credit as insured deposits. FDIC Brief, p. 8. The FDIC made no such claim before the courts below. Moreover, it appears from an examination of the FDIC's early regulations on the issue that its "settled views" (FDIC Brief, p. 7) are at odds not only with the statute itself but also with its own earliest announced position on the matter.

In the Banking Act of 1935, Pub. L. No. 305, 49 Stat. 684 (1935), the FDIC was authorized by regulation to expand the definition of "deposit" contained in the Act to comport with general banking usage. *Id.* at 685-86. The FDIC thereupon promulgated Regulation I. Regulation I, in which the definition of "deposit" now appearing in 12 U.S.C. § 1813(*l*)(1) first appeared, provided that "letters of credit must be regarded as issued for the equivalent of money when issued in exchange for. . . promissory notes upon which the person procuring [the credit] is primarily or secondarily liable." Regulation I(c),(d), 12 C.F.R. § 301.1(c),(d) (1939), quoted in *Federal Deposit Insurance Corp. v. Irving Trust Co.*, 137 F. Supp. 145, 147-48 (S.D.N.Y. 1955). Plainly, the FDIC did not distinguish between "funded" and "unfunded" letters of credit, or make any other distinction about letters of credit, in its first regulation addressing deposit insurance for letters of credit.

In 1960, this language was incorporated virtually unchanged into the Federal Deposit Insurance Act, 12 U.S.C. § 1811 *et seq.* This legislation was designed primarily to simplify the method of determining insurance assessments, and there is no indication in the legislative history of any particular attention directed by Congress toward the question of the status of letters of credit as insured deposits. *See* H.R. Rep. No. 1827, 86th Cong., 2d Sess. 1-6 (1960); S. Rep. No. 1821, 86th Cong., 2d Sess. (1960), *reprinted in* 1960 U.S. Code Cong. and Admin. News 3234, 3239-40, 3243.

The FDIC contends that there is nothing in the legislative history indicating Congress's dissatisfaction with the FDIC's unwritten application of Regulation I. Putting aside the question whether Congress was even

aware that the FDIC was not following its own regulation on the issue, there is nothing in the legislative history indicating any Congressional intent to depart from the clear language of Regulation I and the present statute. Neither the above-cited committee reports, nor the debates on the floors of the House and the Senate (see 106 Cong. Rec. 14794-800, 15622 (1960)), provide any such indication.

The weight that should be given to a federal agency's interpretation of a statute depends on the thoroughness evident in its consideration and the validity of its reasoning. *Adamo Wrecking Co. v. United States*, 434 U.S. 275, 287 n.5 (1978), citing *Skidmore v. Swift and Co.*, 323 U.S. 134, 140 (1944). The FDIC offers no well-considered and thorough analysis, only an admitted departure in practice from the clear language of its earliest regulation on the issue and the statute itself. Nor is there contained in the statute an express delegation by Congress to the FDIC of authority to narrow by regulation the definition of "deposit" contained in 12 U.S.C. § 1813. The threshold requirements for according special deference to an agency's interpretation of a statute are simply not met here.

(b) The letter of credit was issued in exchange for money or its equivalent.

Section 1813(*l*)(1) specifically provides that a letter of credit "*must be regarded* as evidencing the receipt of the equivalent of money" when it is issued in exchange for a "promissory note". (Emphasis added.) Congress's use of the term "promissory note" in the statute is unfettered by the equivocations proffered by the FDIC in its brief. The only question is whether the issuing bank received a

promissory note* from its customer; if it did, a letter of credit issued in exchange therefor *must be regarded* as evidencing the receipt of the equivalent of money.

The FDIC's view is that this statutory language can be explained away by being held to cover only situations where an issuing bank actually funds the loan evidenced by the promissory note, keeps the loan proceeds, and issues a letter of credit in exchange for such proceeds. This view would render nugatory the language of Section 1813 equating promissory notes with "money or its equivalent." A letter of credit issued in those circumstances is actually issued for money, not for a promissory note, and so fits within Section 1813(*l*)(1) without reference to the proviso. Because a court must, if possible, give effect to every phrase of a statute so that no part is rendered superfluous, *National Insulation Transportation Committee v. Interstate Commerce Comm'n*, 683 F.2d 533 (D.C. Cir. 1982), Section 1813(*l*)(1) should be interpreted to mean exactly what it says and no less.

(c) The letter of credit was one on which the issuing bank was primarily liable.

The FDIC's argument that the issuing bank in this case was not "primarily liable" within the meaning of Section 1813(*l*)(1), and its reliance upon the practical (not legal) distinction between "commercial" and "standby" letters of credit, are based upon a misconception of the liability to which the statute is addressed. The statute directs the inquiry toward liability on the letter of credit, not liability

*The promissory note given to the issuing bank to secure respondent's letter of credit contains no qualifications on its face to the unconditional promise to pay contained therein. *See* U.C.C. §3-105(2)(A) and Official Comment.

on the underlying transaction that gave rise to its issuance. The liability of an issuing bank on its letter of credit is determined solely by reference to the face of the letter; if its conditions are satisfied, the bank is liable without reference to the relative rights and obligations of its customer and the letter's beneficiary. U.C.C. § 5-114(1) (1972 Official Version); *First Empire Bank v. Federal Deposit Insurance Corp.*, 572 F. 2d 1361, 1366 (9th Cir.), *cert. denied*, 439 U.S. 919 (1978); *Pringle-Associated Mortgage Corp. v. Southern National Bank*, 571 F. 2d 871, 874 (5th Cir. 1978); *Venizelos, S.A. v. Chase Manhattan Bank*, 425 F. 2d 461, 464-65 (2d Cir. 1970). The issuing bank was clearly primarily liable on the letter of credit it issued to respondent in this case.

The FDIC's claim that the limiting term "primarily liable" was rendered meaningless in the court of appeals' analysis, if issuing banks are always primarily liable on their letters of credit, avoids an easily apparent way to construe the statute. It appears that the FDIC in Regulation I meant the limiting phrase "primarily liable" to refer solely to traveler's checks, and not to letters of credit. In 1954, the FDIC amended Regulation I by changing the placement of the limiting term "primarily liable" to make it clear that it had been its "consistent interpretation . . . of the term 'letters of credit' to include all letters of credit issued for money or its equivalent or for a charge against a deposit account. *See* 12 C.F.R. § 326.1(c) n.2 (1955). In Regulation I, therefore, the FDIC distinguished neither between "funded" and "unfunded" letters of credit, nor between "commercial" or "standby" letters of credit.

2. *None of the Considerations Set Forth in Supreme Court Rule 17 Governing Review on Certiorari are Present in this Case.*

The decision below is not in conflict with a decision of any other federal court of appeals on the same matter. The importance of the decision has also been greatly exaggerated by the FDIC. The FDIC contends that the ruling below would provide federal deposit insurance coverage to approximately $120 billion in outstanding standby letters of credit — ignoring the fact that the decision is limited to such letters of credit as are issued in exchange for promissory notes. There are no statistics available to determine the outstanding amount of such standby letters of credit. The FDIC's estimates about the amounts of possible additional annual assessments of member banks (stated to be approximately $100 million) must likewise be discounted. Moreover, even as to standby letters of credit that are backed by promissory notes, the FDIC's deposit insurance liability would ensue in cases where the issuing bank has failed *and* the account party is unable to pay on the promissory note, and, in any event, only to the amount of $100,000 for each standby letter of credit. The decision below is simply not the watershed that the FDIC has depicted.

Likewise, the potential impact of the ruling below on the tax exempt status of certain industrial revenue bond issues has been overstated by the FDIC. There is no agreement among bond specialists about what, if any, effect the decision below would have. *See, e.g.*, Ferris, *FDIC Submits Bill to Congress to Protect Tax Exemption of Letter-Backed Bonds*, American Banker, April 2, 1985, at 11. Moreover, under the ruling below, any question about the tax exempt status of such bonds when backed by standby

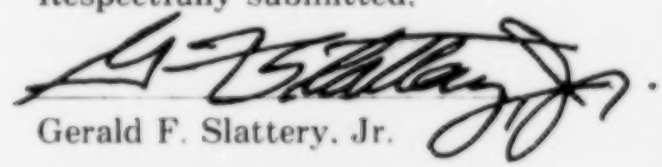
letters of credit can be eliminated simply, if promissory notes are not received by the issuing banks in exchange for the letters of credit.

Finally, the FDIC has introduced legislation that would nullify any of the supposed consequences of the decision below by eliminating the status of most letters of credit as insured deposits. *See* S. 760, 99th Cong., 1st Sess. (1985). Clearly, this Court should let Congress decide whether the decision below warrants a change in the language of Section 1813.

CONCLUSION

The absence of any of the considerations set forth in Supreme Court Rule 17 governing review on certiorari and the absence of any indication that the clear and unambiguous terms of the statute were departed from by the court of appeals suggest that the petition for a writ of certiorari should be denied.

Respectfully submitted,



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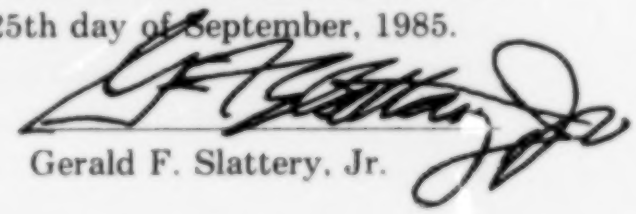
CERTIFICATE

I hereby certify that I have served three copies of the above and foregoing Brief in Opposition to Petition for Writ of Certiorari on Charles Fried, Acting Solicitor General, Department of Justice, Washington, D. C. 20530, by placing signed copies thereof in the United States mail, postage prepaid, on this 25th day of September, 1985.



Gerald F. Slattery, Jr.

APPENDIX A

12 U.S.C. §1813(*l*)(1)

§1813. Definitions

As used in this chapter-

(*l*) The term "deposit" means-

(1) the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank or a letter of credit or a traveler's check on which the bank is primarily liable: *Provided*, That, without limiting the generality of the term "money or its equivalent," any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such bank for collection.

REPLY

BRIEF

Supreme Court, U.S.
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No. 84-1972 (4)

In the Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION, PETITIONER

v.

PHILADELPHIA GEAR CORPORATION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY MEMORANDUM FOR THE PETITIONER

CHARLES FRIED
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Most of respondent's brief in opposition is a challenge to the FDIC's reading of 12 U.S.C. 1813(*l*)(1). But respondent points to nothing that makes deference to the FDIC's interpretation of the statute inappropriate. And it offers no reason to believe that the effects of the decision below will be anything other than immediate and nation-wide. Respondent accordingly offers no reason for this Court to deny review.

1. Respondent first argues (Br. in Opp. 3-4) that the FDIC's interpretation of 12 U.S.C. 1813(*l*)(1) is not due deference because it has not been applied consistently. As we explain in our petition (at 8-9), however, from the moment that it promulgated Regulation I — the progenitor of Section 1813(*l*)(1) — in 1935, the FDIC consistently has declined to treat standby letters of credit as deposits. See Transcript of Notes Taken at a Special Meeting of N.Y. Bank Comptrollers and Auditors Conference at 25-26

(Sept. 27-28, 1935), quoted in *FDIC* v. *Irving Trust Co.*, 137 F. Supp. 145, 161 (S.D.N.Y. 1955). Indeed, to our knowledge the FDIC never has assessed a deposit insurance premium on such an obligation and never has paid a claim relating to such an obligation.

Respondent's further suggestion (Br. in Opp. 4-5) that Congress was unaware of the FDIC's position when it enacted Section 1813(*l*)(1) in 1960 is equally insupportable. Congress placed the language of Regulation I directly in the United States Code (see Pet. 9-10), and it can be presumed in such circumstances that Congress was familiar with the regulation's administrative history. See, *e.g.*, *Lorillard* v. *Pons*, 434 U.S. 575, 580 (1978). And in this case, there is more than a presumption at work: the FDIC's interpretation of Regulation I was set out and endorsed by the court in *FDIC* v. *Irving Trust Co.*, *supra*, and that decision was called to Congress's attention in 1960. See *Federal Deposit Insurance Act: Hearings on H.R. 8916 and H.R. 8928 Before the House Comm. on Banking and Currency*, 86th Cong., 2d Sess. 112-113 (1960) (statement of Royal L. Coburn).

2. Respondent next suggests (Br. in Opp. 5-6) that the statutory language is so clear as not to bear administrative interpretation. Section 1813(*l*)(1) defines a deposit as "money or its equivalent * * * evidenced by * * * a letter of credit." Because the statute further provides that issuance of a letter of credit "must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for a promissory note," respondent maintains that Orion's back-up note — for which the letter was issued — must be regarded as the equivalent of money. But the term "promissory note" is not itself defined in Section 1813(*l*)(1), and it hardly can be the case that anything denominated a "note" by the parties to a transaction necessarily is a "promissory note" within the meaning of the

statute. That conclusion "would only encourage subterfuge and deception." *Gilman* v. *Commissioner of Internal Revenue*, 53 F.2d 47, 50 (8th Cir. 1931).

As we explain in the petition (at 14), the drafters of Regulation I accordingly would not have understood a contingent or back-up note to be a promissory note within the normal meaning of that term.[1] To the contrary, the drafters surely realized that a contingent note — which does not represent existing debt, and which a bank cannot carry on its books as an asset, cannot lawfully negotiate to a third party, and cannot pledge as collateral for its own operations — is in no meaningful sense the equivalent of money. Yet respondent offers no reason to believe that a beneficiary of a letter of credit backed by a valueless note should be entitled to an insurance payment when the bank holding the note fails.

3. Respondent's analysis of the statute is inadequate for another reason as well. Section 1813(*l*)(1) provides that a letter of credit may represent a deposit only if it was issued for the equivalent of money *and* if the issuing bank was primarily liable on it (see Pet. 16-17). But respondent offers no convincing rejoinder to the proposition (see Pet. 18) that the "primarily liable" element of the definition would be rendered nugatory if banks were deemed primarily liable on standby as well as commercial letters of credit. Respondent appears to suggest only (Br. in Opp. 7) that the primary liability requirement was intended by the drafters of Regulation I to apply to traveler's checks rather than to letters of credit. In fact, however, the FDIC made it plain — as does the statutory language — that the requirement was and is

---

[1]Indeed, at the time that Congress enacted Section 1813(*l*)(1), FDIC regulations provided that a note (whether or not denominated a "promissory note") backing only a *commitment* to advance funds did not create a deposit. 12 C.F.R. 327.145 and 327.148 (1959).

fully applicable to letters of credit. See 12 C.F.R. 327.209 and 327.210 (1959).

4. Finally, respondent denigrates the significance of the decision below by insisting that it applies only to letters of credit that are backed by notes. It is far from clear, however, that the reach of the court of appeals' holding is so limited, for the court suggested that all letters of credit should be deemed to represent the receipt of money or its equivalent (see Pet. 15).[2] Indeed, even if the opinion is read narrowly, the limitation identified by respondent is not a substantial one: it would permit the parties to a transaction to obtain federal insurance for their deal simply by executing an unsecured back-up note.[3] Respondent also maintains (Br. in Opp. 8-9) that there is disagreement among the experts about the effect of the decision below on the tax status of industrial revenue bonds. As we explain in the petition (at 20-21), however, it is this very uncertainty that is disrupting the sensitive market in such bonds.[4]

---

[2]Moreover, to the extent that there is uncertainty about the scope of the court of appeals' ruling, prudence might require the FDIC to assess insurance premiums (see Pet. 19-20) on the assumption that all standby letters of credit represent insured deposits that may lead to claims on the FDIC insurance fund. As we noted in the petition (*ibid.*), this action alone could make banks liable for additional assessments amounting to hundreds of millions of dollars.

[3]While the exchange of a back-up note for a letter of credit is a common transaction, the FDIC in the past has treated as uninsured all $120 billion worth of outstanding standby letters of credit; it therefore does not maintain records of the number of letters backed by notes.

[4]While respondent correctly notes (Br. in Opp. 9) that a bill has been introduced in Congress to correct the court of appeals' decision, no action has been taken on the proposed legislation.

For the foregoing reasons and the reasons stated in the petition, it is respectfully submitted that the petition for a writ of certiorari should be granted.

CHARLES FRIED
Acting Solicitor General

OCTOBER 1985

PETITIONER'S

BRIEF

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QUESTION PRESENTED

Whether an unfunded standby letter of credit is a deposit within the meaning of 12 U.S.C. 1813(*l*)(1) for purposes of the federal deposit insurance program.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-19a) is reported at 751 F.2d 1131. The February 9, 1984 order of the district court (Pet. App. 20a-45a) is unreported.

JURISDICTION

The judgment of the court appeals was entered on December 27, 1984. A petition for rehearing was denied on February 19, 1985 (Pet. App. 46a). On May 10, 1985, Justice White extended the time within which to file a petition for a writ of certiorari to and including June 19, 1985. The petition was filed on that date and was granted on October 21, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTE INVOLVED

12 U.S.C. 1813(*l*)(1) provides:

> The term 'deposit' means—
>
> (1) the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank, or a letter of credit or a traveler's check on which the bank is primarily liable: *Provided*, That, without limiting the generality of the term 'money or its equivalent', any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such banks for collection.

STATEMENT

1. The Orion Manufacturing Corporation (Orion) produced drilling equipment. One of its suppliers was respondent, the Philadelphia Gear Corporation. Pet. App. 2a. On April 23, 1981, on Orion's application, Penn Square Bank, N.A. (Penn Square), a national banking association doing business in Oklahoma City, Oklahoma, issued a so-called unfunded standby letter of credit for the benefit of respondent

in the amount of $145,200.[1] The letter was intended to guarantee that respondent would receive payment for its equipment in the event of a default by Orion (Pet. App. 5a). To this end, the letter obligated Penn Square to pay respondent upon receipt of the latter's "signed statement that [it] ha[d] invoiced Orion, * * * and said invoices ha[d] remained unpaid" (*id.* at 3a).[2] As security for this undertaking, Orion executed a contingent, unsecured "backup" note in the amount of $145,200 in favor of Penn Square,

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[1] A standby letter of credit functions as a guarantee mechanism in which the issuing bank (the "issuer") undertakes to pay a third party (the "beneficiary") in the event that the bank's customer does not itself make payment to the beneficiary. The issuer generally must make payment on the letter when the beneficiary presents documents establishing the customer's default. See generally Comment, *The Independence Rule in Standby Letters of Credit*, 52 U. Chi. L. Rev. 218, 219-220, 222-226 (1985). Such letters typically are unfunded (that is, they are not supported by funds on deposit with the bank), because banks do not anticipate having to pay out on them; the customer simply agrees that the bank will be reimbursed if it is forced to pay out on the letter. In contrast, traditional "commercial" letters of credit are not contingent on a default. They function as a payment mechanism; in the typical case, the letter will obligate the issuing bank to pay the seller of goods upon the presentation of a bill of lading indicating that the seller has made delivery to the buyer, the bank's customer. See *id.* at 218-219. Such letters generally are backed (or funded) by the customer's placement of funds into an account in the issuing bank in an amount sufficient to pay the seller. See U.C.C. §§ 5-114, 5-117 official comment (1985); Resnick, *The Risky New Wrinkles in Letters of Credit*, N.Y. Times, Nov. 11, 1984, § 3, at 8-9. See generally Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716 (1973).

[2] The letter is set out in the opinion of the court of appeals at Pet. App. 3a-4a.

which the bank would draw upon for reimbursement if it was forced to pay respondent under the letter of credit (*id.* at 3a, 5a-6a, 23a). Although this condition was not expressed in the note, both Orion and Penn Square "understood that nothing would be considered due on this note nor would interest be charged unless and until [respondent] presented to Penn Square the requisite documents detailed in the letter of credit" (*id.* at 5a).

On July 5, 1982, the Comptroller of the Currency declared Penn Square insolvent, and appointed the Federal Deposit Insurance Corporation (FDIC or Corporation) as its receiver pursuant to 12 U.S.C. 1821(c). Over the next several weeks respondent sought payment under the letter of credit from the FDIC in its capacity as receiver,[3] citing defaults by Orion that had occurred prior to the bank's failure but that had not been presented to the bank at that time. The FDIC, however, declined to honor drafts on the letter of credit. Pet. App. 4a.

Respondent then brought this suit against the FDIC in its capacity both as receiver and as insurer of deposits, claiming, among other things, that the letter was a "deposit" insured by the FDIC under 12 U.S.C. 1813(*l*)(1). That provision, in relevant part, defines a deposit as

> [T]he unpaid balance of money or its equivalent received or held by a bank in the usual course of business and * * * which is evidenced by * * * a letter of credit * * * on which the bank is primarily liable: *Provided*, That, without limiting the generality of the term 'money or its equivalent', any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for * * * a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable.

[3] The FDIC's role as receiver is distinct from its corporate role as insurer of bank deposits. See 12 U.S.C. 1819 Ninth; *FDIC* v. *Ashley*, 585 F.2d 157 (6th Cir. 1978).

As the beneficiary of the letter, respondent maintained that it was a depositor entitled to the statutory maximum of $100,000 in insurance proceeds as compensation for the loss of the "deposit" that had been evidenced by the letter of credit (Pet. App. 2a, 4a). See 12 U.S.C. 1813(m).

2. The United States District Court for the Western District of Oklahoma ruled for respondent. The court did not dispute the FDIC's contention that the backup note "was merely a conditional debt, contingent on the letter's being called," "that it was not a liability of Orion until that time," and that "Penn Square Bank never considered [the note] an asset" (Pet. App. 40a). But the court reasoned that, under Section 1813(*l*)(1), an instrument "'*must be regarded* as evidencing the receipt of the equivalent of money when created or issued in exchange for . . . a promissory note'" (Pet. App. 40a; emphasis added by the court). It therefore held that, "although the letter of credit was not issued in exchange for legal tender, it must be *considered* as having been issued in exchange for 'money or its equivalent' because it was issued in exchange for Orion's promissory note" (*ibid.*; emphasis in original). The court accordingly ordered the FDIC in its capacity as insurer to pay respondent $100,000 in insurance proceeds.[4]

[4] The district court also ruled that FDIC, in its capacity as receiver, was obligated to pay respondent $45,200 (the face

In relevant part, the court of appeals affirmed (Pet. App. 1a-19a).[5] The court premised its opinion on the understanding that Congress had not "explicitly delegated to the FDIC authority to refine the definition of a deposit contained in § 1813," and that the Corporation had not in any event promulgated regulations "pinpointing § 1813's precise meaning" (Pet. App. 8a). In these circumstances, the court concluded that the FDIC's views on the meaning of the statute were due no special deference (*ibid.*).[6]

With this understanding of the weight that should be given the FDIC's views, the court began its opinion by holding that Penn Square had received "money or its equivalent" in connection with the letter—that is, Orion's contingent back-up note. While the court acknowledged that both Orion and Penn Square understood that "nothing would be considered due on this note" unless Orion defaulted and respondent made a proper demand (Pet. App. 5a), it nonetheless found that the note was negotiable on its face (*id.* at 6a) and thus, evidently, was by its nature the equivalent of money (*ibid.*). And even apart from

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value of the letter adjusted by the $100,000 insurance award) in the form of a receiver's certificate (Pet. App. 27a-36a, 44a-45a). This contractual ruling is not at issue here.

[5] The court of appeals overturned the district court's award of prejudgment interest to respondent (Pet. App. 15a-16a). Respondent has not challenged the validity of that holding.

[6] Although these statements were made during the course of the Tenth Circuit's analysis of "primary liability" (see note 7, *infra*), the court's view of the FDIC's regulatory role presumably affected its holding on the other issues in the case as well. Indeed, in the discussion of the other issues the court failed even to suggest that the FDIC has special expertise in interpreting Section 1813(*l*)(1).

the negotiability of the note, the court found the "money or its equivalent" aspect of Section 1813(*l*)(1)'s definition satisfied simply because "[t]he bank's customer had signed a promissory note obligating it to repay advances made by the bank" (Pet. App. 6a).

The court also offered several further considerations in support of its conclusion. Because it found that a bank's liability under a standby letter of credit is nearly absolute, it reasoned that the FDIC will not have difficulty in determining the amount of a bank's obligation for assessments to the Corporation's insurance fund (which are based on total deposits, see 12 U.S.C. 1817). Pet. App. 12a. And it noted that Section 1813(*l*)(1) on its face refers to letters of credit generally without distinguishing between the different types; because Congress nowhere stated that standby or unfunded letters should be excluded from the definition, "the plain language of § 1813 dictates the conclusion that these instruments are within the statutory definition of a 'deposit.'" Pet. App. 13a.[7]

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[7] The court also held that the letter of credit was one on which Penn Square was "primarily liable" (Pet. App. 7a-11a) and that respondent was a "depositor" entitled to recover any insurance proceeds (*id.* at 13a-15a), and rejected the FDIC's argument that respondent's claims were unrecorded liabilities (see 12 U.S.C. 1822(c)) (Pet. App. 14a-15a). Those conclusions are not challenged here. At the same time, the court of appeals affirmed the district court's conclusion that the FDIC in its capacity as receiver owed respondent $15,200 in the form of a receiver's certificate, rejecting respondent's contention that the letter of credit should have been valued at $724,658.50 rather than $145,200.00 (*id.* at 16a-19a). This holding also is not at issue here.

SUMMARY OF ARGUMENT

A. The FDIC and the federal deposit insurance program were created as a response to the banking crisis that followed on the Depression. The purpose of that program was plain from the beginning: it was to safeguard the "hard earnings" of the public, and in that way to restore confidence in the banking system. 77 Cong. Rec. 3837 (1933) (remarks of Rep. Steagall). The protections of federal deposit insurance thus come into play only when necessary "to prevent the destruction of deposits because of bank failure and to protect depositors against loss." S. Rep. 1821, 86th Cong., 2d Sess. 2 (1960). And because it is only a customer who delivers his own funds to a bank who risks loss if the bank suspends operations, Congress provided that insured deposits basically are defined as "money or its equivalent received or held by a bank." 12 U.S.C. 1813(*l*)(1); see 12 U.S.C. 1813 (*l*)(2)-(5). When the bank's customer has not entrusted the bank with anything of value, then, there is no deposit in existence that warrants the protection of federal deposit insurance.

The court of appeals, however, did not attempt to determine whether Orion or respondent had in fact entrusted the bank with anything of value. Instead, the court noted that 12 U.S.C. 1813(*l*)(1) provides that an instrument must be regarded "as evidencing the receipt of the equivalent of money"—and thus of the "hard earnings" that Congress sought to protect—when a bank issues it in exchange for a "promissory note." Because Orion here signed a document labeled "promissory note," the court held that the Penn Square letter must be considered as evidencing the receipt of money.

In reaching this conclusion, the court below disregarded both the purposes of the statute and economic reality. In fact, the standby letter of credit functioned as a line of credit that Penn Square offered to its customer, Orion. Orion's backup note served simply to evidence this undertaking. The note created no present indebtedness and bore no interest; Penn Square could not obtain value for it, offset it against any obligation that the bank had to Orion, or accelerate Orion's obligation. Thus, Penn Square at no point during the transaction functioned as a depository, and Orion at no point had its funds at risk. In these circumstances, treating the letter of credit secured by Orion's backup note as an insured deposit would be contrary to the purposes of the federal deposit program and provide respondent with a windfall, because nothing of value ever was deposited with Penn Square.

The court of appeals' error thus lay in its assumption that Section 1813(*l*)(1) was intended to provide insurance protection to all instruments backed by documents termed "promissory notes," regardless of whether the promissory notes actually are the equivalent of money. Congress plainly would not have wanted a standby letter of credit backed by a contingent note to be regarded as evidencing an insured deposit: such an application of the statute serves neither to protect "hard earnings" nor to bolster depositor confidence in the integrity of banking institutions. Indeed, the other instruments described in Section 1813(*l*)(1) as the equivalent of money all represent unconditional obligations—and it appears that the drafters of the current "deposit" definition would not have understood a contingent note to be a "promissory note" within the ordinary meaning of

that term. That the note may have been negotiable (because the conditions attached to Orion's liability were spelled out in a separate document) should not change this conclusion, since the agreement between the parties meant that Penn Square could not have negotiated the note unless the bank actually had advanced funds to respondent.

B. The court of appeals compounded its error by failing to accord any deference to the FDIC's interpretation of Section 1813(*l*)(1). The FDIC has been entrusted with the administration of the statute for 50 years, and Congress plainly has indicated that the Corporation's interpretation of Section 1813 must be accorded the greatest deference. See 12 U.S.C. 1813 (*l*)(5) and 1819 Tenth. The Corporation's views therefore must be given controlling weight unless they are manifestly improper. See, *e.g.*, *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 5-7.

Even beyond that, however, on the particular question in this case, the legislative history indicates that the FDIC's construction of the statute should be dispositive. The definition of deposit that now appears in Section 1813(*l*)(1) was first used in Regulation I, issued by the FDIC in 1935. From the moment of the Regulation's promulgation, the FDIC informally but consistently declined to treat unfunded standby letters of credit as deposits. The FDIC accordingly never has assessed insurance premiums on letters of credit of the sort at issue here—and never has paid out on insurance claims relating to such letters—because it has not treated them as deposits. And Congress, far from disapproving the FDIC's longstanding interpretation, actually *incorporated* Regulation I's language concerning letters of credit and promissory notes directly into what is now Section 1813(*l*)(1). These circumstances present the clearest imaginable case for deference to the FDIC. See *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979); *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978).

C. The court of appeals also disregarded the reliance on the FDIC's view that has been demonstrated both by the banking industry and by Congress itself. Treating unfunded standby letters of credit as deposits would increase insured bank deposits by some 8%, while proportionately reducing the ratio of the FDIC's insurance fund to deposits outstanding. Premium adjustments designed to ameliorate this problem would, in turn, impose substantial additional costs on banks, thus putting FDIC-insured institutions at a serious disadvantage vis-a-vis foreign or other non-insured institutions in arranging standby letter of credit transactions. This sort of disruption should be avoided absent the most compelling reasons. See *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 457-458 (1978).

Equally as significant, Congress has legislated with the FDIC's reading of Section 1813(*l*)(1) in mind. It has provided that so-called industrial revenue bonds are exempt from federal tax unless guaranteed by the federal government—while explaining that such bonds should not be viewed as federally-guaranteed simply because they are backed by standby letters of credit. The decision below, which leads to the conclusion that bonds backed by such letters are federally-guaranteed, disregarded this scheme.

ARGUMENT

AN UNFUNDED STANDBY LETTER OF CREDIT DOES NOT EVIDENCE A DEPOSIT THAT IS COVERED BY FEDERAL INSURANCE

The court of appeals' decision is based on several fundamental misconceptions. Its holding that unfunded standby letters of credit are deposits within the meaning of Section 1813(*l*)(1) disregards both economic reality and the purposes of the federal deposit insurance program: the decision affords the benefits of federal deposit insurance to the beneficiary of a financial instrument that simply does not represent deposited funds. In so doing, the court entirely disregarded the settled views of the agency that for some 50 years has applied the current statutory definition of the term "deposit." And it upset both subsequent congressional action and settled industry practice that are grounded on the validity of the FDIC's approach.

A. A Deposit Comes Into Existence Only When Something Of Value Is Entrusted To A Bank

1. a. The FDIC and the federal deposit insurance program were created by the Banking Act of 1933, ch. 89, 48 Stat. 162 *et seq.*, as a response to the crisis caused by the public's loss of confidence in banking institutions during the Depression.[8] See generally

[8] The 1933 Act created the FDIC through the addition of a Section 12B to the Federal Reserve Act (48 Stat. 168). See 12 U.S.C. 1811 note. Section 12B was amended frequently in subsequent years (see 12 U.S.C. 1811 note; pages 23-25, *infra*). In 1950, Section 12B was removed from the Federal Reserve Act and set out separately as the Federal Deposit Insurance Act of 1950 (FDI Act), ch. 967, 64 Stat. 873 *et seq.* See 12 U.S.C. 1811 note; H.R. Rep. 2564, 81st Cong., 2d Sess. 5 (1950); S. Rep. 1269, 81st Cong., 2d Sess. 4 (1950). Section 1813(*l*)(1) is now a part of the FDI Act.

S. Rep. 77, 73d Cong., 1st Sess. 5-6, 12-13 (1933). The spate of bank failures during that period meant that "a very large number of persons [were] unable to meet their obligations and [that] many business houses [were] embarrassed through inability to get the use of their funds." *Id.* at 12. As a result, depositors naturally reacted to the specter of bank insolvencies (see *id.* at 5-6) by engaging in massive runs on banks, which culminated in the national "bank holiday" declared by President Roosevelt on March 6, 1933. See 19 Fed. Res. Bull. 113-132 (1933); 12 Cong. Dig. 98-105 (1933). See generally 77 Cong. Rec. 5895 (1933) (remarks of Rep. Steagall).

Against this background, the purpose of the insurance program was plain from the beginning: it was "to make the savings of America safe" (77 Cong. Rec. 5862 (1933) (remarks of Sen. Vandenberg)) by fostering the "establishment and maintenance of a system of banks in the United States where citizens may place their hard earnings with reasonable expectation of being able to get them out again" (*id.* at 3837 (remarks of Rep. Steagall)). See S. Rep. 77, *supra*, at 11, 14; 77 Cong. Rec. 3837 (1933) (remarks of Rep. Blanton); *ibid.* (remarks of Rep. Carpenter); *id.* at 5895 (remarks of Rep. Steagall); *id.* at 5896 (remarks of Rep. Luce).[9] In-

[9] As President Roosevelt stated during his first "fireside chat" with the Nation, shortly after declaring the nationwide "bank holiday," "[i]t needs no prophet to tell you that when people find that they can get their money—that they can get it when they want it for all legitimate purposes—the phantom of fear will soon be laid." *President Roosevelt Delivers His First Fireside Chat, March 12, 1933*, in 4 *Documentary His-*

suring these "hard earnings" and "assets" (S. Rep. 77, *supra*, at 12), it was believed, would restore the "confidence of the public" in the banking system. 77 Cong. Rec. 3837 (1933) (remarks of Rep. Steagall). See *id.* at 5896 (remarks of Rep. Rankin); *id.* at 5862 (remarks of Sen. Vandenberg); *id.* at 3903 (remarks of Rep. Busby).[10]

Given this history, it is evident that the protections of federal deposit insurance were intended to come into play only when necessary "to prevent the destruction of deposits because of bank failure and to

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tory of Banking and Currency in the United States 2708-2711 (1969); Pub. Papers 61-65 (1938).

[10] In designing the federal deposit insurance program, Congress was inspired by the state deposit guarantee systems created in the early twentieth century. See 12 Cong. Dig. 114 (1933) (Rep. Steagall) ("[t]he state depositors' insurance laws pointed the way to a sound national insurance system"). See generally 11 Fed. Res. Bull. 626 (1925); *Legislation: Federal Insurance of Deposits*, 36 Colum. L. Rev. 809 (1936); Note, *Precedents for Federal Bank Deposit Insurance*, 19 St. Louis L. Rev. 62 (1933). These state systems had provided that deposits would be protected only when they represented the equivalent of money entrusted to a bank. See 9 C. Zollman, *Banks and Banking* § 5921, at 102 (1938). And as a rule, the state laws "look[ed] through all semblances and forms to ascertain the actual fact as to whether or not there ha[d] been a bona fide deposit made." *Kidder* v. *Hall*, 113 Tex. 49, 56-58, 251 S.W. 497, 500 (1923). See, *e.g.*, *Spillman* v. *Farmers' State Bank of Dix*, 115 Neb. 574, 214 N.W. 4 (1927); *Spillman* v. *Gross State Bank of Gross*, 113 Neb. 119, 202 N.W. 460 (1925); *Fourth Nat'l Bank* v. *Wilson*, 110 Kan. 380, 204 P. 715 (1922); *Peoples Bank of Dixon* v. *Bone*, 121 Kan. 768, 250 P. 276 (1926). See generally 9 C. Zollman, *Banks and Banking* § 5921, at 102 (1938).

protect depositors against loss." S. Rep. 1821, 86th Cong., 2d Sess. 2 (1960). Because it is only a "customer who delivers his own funds to the bank [who] risks their total or partial loss if the bank should suspend operations" (*FDIC* v. *Irving Trust Co.*, 137 F. Supp. 145, 162 (S.D.N.Y. 1955)), Congress achieved its purpose by providing that insured deposits basically are defined as "money or its equivalent received or held by a bank." 12 U.S.C. 1813 (*l*)(1); see 12 U.S.C. 1813 (*l*)(2)-(5). If the bank's customer has not entrusted the bank with anything of value, there are no "assets 'tied up'" (S. Rep. 77, *supra*, at 12) when the bank fails, and accordingly no deposit in existence that warrants the protection of federal deposit insurance. The only question in this case, then, is whether Orion entrusted Penn Square with something of value that was lost when Penn Square closed its doors.

b. The court of appeals did not attempt to answer this question by considering whether Orion had in fact entrusted its bank with anything of value. Instead, the court concluded that the case began and ended with the language of the statute. Section 1813(*l*)(1), the court noted (Pet. App. 6a-7a), provides that an instrument must be regarded "as evidencing the receipt of the equivalent of money"—and thus of the "assets" or "hard earnings" that Congress sought to protect—when a bank issues it in exchange for, among other things, a "promissory note." Here, Orion "signed a promissory note" (*id.* at 6a). Therefore, the court held, the unfunded letter must be considered to evidence the receipt of the equivalent of money, because Penn Square issued it in exchange for Orion's contingent backup note (*id.* at 6a-7a).

In reaching this conclusion, however, the court below disregarded both the purposes of the statute and economic reality, for the Orion note plainly was not a "promissory note" of the type that meaningfully may be termed the equivalent of money. In reality, the standby letter functioned as a line of credit that Penn Square offered to its customer, Orion, for the benefit of respondent; as such, the letter had to be included in Penn Square's calculation of its statutory lending limits. See 12 C.F.R. 7.6100, 208.8(d)(2), 337.2(b). Orion's backup note served simply to evidence Orion's repayment obligation. Under the controlling understanding between Orion and Penn Square (see Pet. App. 5a-6a), the liability evidenced by the note was wholly contingent—through the note, Orion simply undertook to repay a debt that might arise in the future if certain contingencies occurred—so that the note created no present indebtedness and bore no interest.

Such a contingent instrument is in no economic sense the equivalent of money.[11] Neither Orion nor respondent deposited any funds with the bank, or obligated itself to entrust anything of value to the bank, when Orion issued the note; there was nothing that either could "withdraw" on demand. Because

[11] This has been recognized by the Board of Governors of the Federal Reserve System (Board). While the Board's definition of "deposit" is in terms quite similar to that in the Section 1813(*l*) (see 12 C.F.R. 204.2(a)(1)(i)), the Board has made it plain that obligations "represent[ing] a conditional, contingent or endorsers liability" are excluded from its definition. 12 C.F.R. 204.2(a)(2)(ii). The Board's approach has special significance here because Congress intended each of the federal banking agencies to use an identical definition of "deposit" to avoid imposing dual reporting requirements on FDIC-insured banks. See S. Rep. 1821, *supra*, at 7.

the note did not represent an existing debt, Penn Square could not realistically expect to obtain value for it. And the contingent nature of the note meant that the bank could not offset it against any obligation that it had to Orion, or sue on or accelerate Orion's obligation. See generally Ryan, *Letters of Credit Supporting Debt for Borrowed Money: The Standby as Backup*, 100 Banking L.J. 404, 413 (1983). Thus, Penn Square at no point during the transaction functioned as a depository, and Orion at no point had its "own funds [at] * * * risk[] * * * [had] the bank * * * suspend[e]d operations." *Irving Trust*, 137 F. Supp. at 162. In these circumstances, treating the letter of credit secured by Orion's backup note as an insured deposit would be contrary to the purposes of the federal deposit program and provide respondent with a windfall, because nothing of value ever was deposited with Penn Square.

c. The court of appeals' error, then, lies in its assumption that Section 1813(*l*)(1) was intended to provide insurance protection to all instruments backed by documents termed "promissory notes," rather than to those instruments issued in exchange for promissory notes that are sufficiently valuable to be deemed the equivalent of money.[12] A deposit obligation, of course, may be created in exchange for a promissory note that represents an unconditional liability; that is why Congress provided that promissory notes should be regarded as evidencing the equivalent of money. Cf. 77 Cong. Rec. 3905 (1933) (remarks of

[12] The analysis used below was perhaps most clearly stated by the district court, which read the statute to provide that, whether or not the letter represented an actual obligation, it "must be *considered* as having been issued in exchange for 'money or its equivalent' because it was issued in exchange for Orion's promissory note" (Pet. App. 40a; emphasis in original).

Rep. Busby); *Federal Deposit Insurance Act: Hearings on H.R. 8916 and H.R. 8928 Before the Subcomm. of the House Comm. on Banking and Currency*, 86th Cong., 2d Sess. 26 (1960) ("if [a] bank purchases [a] promissory note and gives credit for the purchase price thereof, a liability is created which is a deposit"). But whether a deposit has come into existence turns on the nature of the note, rather than its label.[13] That this was Congress's intent is demonstrated by the other terms of the statute. The proviso to Section 1813 (*l*)(1) states that an instrument (such as a letter of credit) "must be regarded as evidencing the receipt of the equivalent of money" when issued in exchange for a promissory note or for "checks or drafts * * * or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded * * * for collection." All of these instruments have a substantial present value, and all represent unconditional obligations. Obviously, the inclusion on this list of a conditional back up note would have been highly anomalous. Cf. *Fedorenko* v. *United States*, 449 U.S. 490, 512 (1981). In fact, the legislative background provides strong evidence that Congress would not have anticipated such a reading of Section 1813(*l*)(1): when the current statutory definition first became effective in 1935 (see page 23, *infra*), a contingent note generally was not understood to be "promissory note" within the ordinary meaning of that term. See, *e.g.*,

[13] Similarly, it is not significant that the controlling conditions that made the note contingent were spelled out in a separate agreement between Orion and Penn Square, rather than on the face of the backup note itself. Any other conclusion would allow the parties to such agreements to obtain federal insurance for their transactions simply by engaging in clever drafting.

16 Fed. Res. Bull. 520 (1930) (Regulation A) (emphasis added) (defining promissory note as "an *unconditional* promise * * * to pay * * * at a fixed or determinable future time, a sum certain in dollars"); *Gilman* v. *Commissioner of Internal Revenue*, 53 F.2d 47 (8th Cir. 1931) (instrument is not a promissory note if there is no unconditional commitment to pay on it).

Indeed, it is impossible to imagine why Congress would have wanted a standby letter of credit backed by a conditional note to be regarded as evidence of an insured deposit. Because the standby letter essentially creates a lending relationship between the bank and its customer, the court of appeals' decision —as the facts here demonstrate—causes the federal deposit insurance program not to protect "hard earnings" against loss, but instead to guarantee business transactions financed by standby letters. Such an application of the statute hardly seems necessary to inspire "depositor confidence" (77 Cong. Rec. 5862 (1933) (remarks of Sen. Vandenberg)).

The determination whether Orion's back-up note was the equivalent of money also should not be affected by the court of appeals' finding (see Pet. App. 6a) that the note was negotiable on its face because the conditions attached to Orion's liability were not addressed in the note itself. That a note may in a technical sense be a negotiable instrument hardly answers the question whether it is the equivalent of money for purposes of the federal deposit insurance program. Given the agreement between the parties, Penn Square obviously could not have negotiated the note against Orion until the bank actually advanced funds to respondent. And while Penn Square conceivably could have sold the note fraudulently to an innocent third party, it is difficult to believe that

Congress intended to define as "money or its equivalent" an instrument that becomes valuable only when used unlawfully. Accordingly, whether this particular note was technically negotiable was wholly immaterial to the purpose of the deposit insurance program: protecting funds that depositors have entrusted to banks. Here, no such funds (or their realistic equivalent) were deposited.

3. While the court of appeals relied primarily on the promissory note proviso to Section 1813(*l*)(1) in finding that the letter of credit here was issued for money or its equivalent, the court also noted that, under the plain language of the statute, the term "deposit" includes the equivalent of money "received or held by a bank * * * which is evidenced by * * * a letter of credit * * * on which the bank is primarily liable." Because a letter of credit is involved in this case, the court concluded that the instruments here "are within the statutory definition of a 'deposit'" (Pet. App. 13a). But in reaching this conclusion the court of appeals entirely disregarded the first portion of the statutory definition, for here the bank did not obtain money or its equivalent in exchange for the standby letter; it received only the contingent backup note. Cf. *In re F & T Contractors, Inc.*, 718 F.2d 171, 181 (6th Cir. 1983) (standby letters are "contingent liabilities" that are supported by "contingent assets"). Indeed, as we have noted, for regulatory purposes standby letters of credit issued for the account of bank customers are aggregated with loans *from* the bank (see 12 C.F.R. 7.6100, 208.8(d)(2), 337.2(b)), rather than with deposits received *by* the bank.[14]

[14] While the FDIC, the Board of Governors of the Federal Reserve System, and the Comptroller of the Currency all have promulgated regulations providing that a bank's deposits must

In any event, there is a basic difference between an unfunded standby letter of credit and the other instruments listed in the first portion of Section 1813(*l*)(1). That portion of the statute provides that the term "deposit" means "money or its equivalent received or held by a bank * * * which is evidenced by its certificate of deposit, * * * or a check or draft drawn against a deposit account and certified by the bank, or a letter of credit or a traveler's check on which the bank is primarily liable." With the exception of unfunded letters of credit, the various listed instruments create unconditional liability of a certain value.[15] A bank becomes liable to pay on an unfunded standby letter of credit only when certain conditions are met, however—and the general expectation is that, in the usual situation, the bank never will become liable on such a letter of credit. See note 1, *supra*.[16]

be set forth on the liability side of its balance sheet, standby letters of credit must be disclosed only in the "general notes" to the sheet. See 12 C.F.R. 11.7(c)(9)(viii), 11.44, 206.7(e)(12)(vii), 335.621, 335.627. If standby letters are deposits, there would of course be no need for this special treatment.

[15] When a bank receives funds in exchange for a letter of credit, it has an unconditional obligation either to pay when the letter is drafted upon, or to reimburse the funds to its customer when the letter expires.

[16] Letters of credit evidently were included in the definition of deposit because there was considerable uncertainty under the old state deposit guarantee programs (see note 10, *supra*) about whether funds deposited with a bank but segregated to meet an specific obligations were guaranteed. Compare *Johnson* v. *Johnson*, 134 Miss. 729, 99 So. 369 (1924) and *Spry* v. *Hirning*, 46 S.D. 237, 191 N.W. 833 (1923) with *Tyler County State Bank* v. *Rhodes*, 256 S.W. 947 (Tex. Civ. App. 1923). In certain circumstances, funds backing a letter of credit

In these circumstances "the essential test [of whether a letter of credit is a deposit] is whether the funds involved are those of the customer himself or funds of the bank which have been made available to the customer under a loan"; it is only in the first situation that the customer risks the loss of "his own funds * * * if the bank should suspend operations before they are paid out to the beneficiary or returned to the customer." *Irving Trust*, 137 F. Supp. at 162. An unfunded letter of credit thus cannot evidence the receipt of money or its equivalent.

B. The Court Of Appeals Failed To Accord Proper Deference To The FDIC's Interpretation Of 12 U.S.C. 1813(*l*)(1)

The court of appeals' error in disregarding the purposes of the Act was compounded by its conclusion that it was entirely free to ignore the FDIC's views on the meaning of the statutory term "deposit." The court flatly asserted (Pet. App. 8a) that the Corporation's views were entitled to no special deference here. In fact, however, the FDIC is the agency that for 50 years has administered the statutory provisions at issue, and Congress plainly has indicated that the FDIC's interpretation of Section 1813 must be accorded great deference. See 12 U.S.C. 1813(*l*)(5) and 1819 Tenth. See also 12 C.F.R. Pt. 330. In such circumstances, the agency's views must of course be given "controlling weight unless they are arbi-

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would fall into this category. See H. Harfield, *Bank Credits and Acceptances* 245-246 (5th ed. 1974). The statute (and its predecessor regulations (see pages 23-25, *infra*)) was written to ensure that such segregated "special deposits" are insured. In identifying a deposit, then, the crucial question is not whether the bank has issued something labeled a "letter of credit"; it is whether the letter was issued for money or its equivalent.

trary, capricious, or manifestly contrary to the statute." *Chevron U.S.A. Inc.* v. *Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip. op. 5-7. As the discussion above demonstrates, the FDIC's reading more than meets this test. But beyond that, on the particular question in this case, the legislative history indicates that the FDIC's construction of the statute should be dispositive.

The relevant portion of the definition of "deposit" that now appears in Section 1813(*l*)(1) was first used in a 1935 FDIC regulation issued pursuant to the Banking Act of 1935, ch. 614, 49 Stat. 684 *et seq.*[17] The Corporation's Regulation I was in all relevant respects identical to the current Section 1813(*l*)(1), providing that "[t]he term deposit shall include * * * letters of credit on which the bank is primarily liable" when those letters are issued "[f]or money or its equivalent" or for "a charge against a deposit account." Regulation I further provided that such instruments would be deemed to have been issued for money or its equivalent when presented "in exchange for * * * promissory notes upon which the person procuring the instrument is primarily liable." 12 C.F.R. 301, 301.1(d) (1939).

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[17] The Banking Act of 1933, which created the FDIC (see page 12, *supra*), did not define insured deposits. The first statutory description of the term appeared in the 1935 Act, which defined a deposit as "the unpaid balance of money or its equivalent received by a bank in the usual course of business and for which it has given or its obligated to give credit to a commercial, checking, savings, time or thrift account, or which is evidenced by its certificate of deposit, and trust funds held by such bank whether retained or deposited in any department of such bank or deposited in another bank, *together with such other obligations of a bank as the board of directors [of the FDIC] shall find and shall prescribe by its regulations to be*

Although the language of Regulation I, like that of the current statute, did not in terms exclude unfunded standby letters of credit from the definition of deposit, from the moment of the regulation's promulgation the FDIC informally but consistently declined to treat such instruments as deposits. Immediately after the regulation went into effect, for example, an FDIC official explained its meaning to banking officials and auditors as follows:

> If your letter of credit is issued by a charge against a depositor's account or for cash and the letter of credit is reflected on your books as a liability, you do have a deposit liability. If, on the other hand, you merely extend a line of credit to your customer, you will only show a contingent liability on your books. In that event no deposit liability has been created.

Transcript of Notes Taken at a Special Meeting of N.Y. Bank Comptrollers and Auditors Conference 25-26 (Sept. 27-28, 1935), quoted in *Irving Trust*, 137 F. Supp. at 161.[18] From 1935 until the time of the decision below, the FDIC accordingly never has assessed insurance premiums on letters of credit of the sort at issue here—and never has paid out on insurance claims relating to such letters—because it has not treated them as deposits.[19] The FDIC's general approach was given judicial recognition by the *Irving Trust* court in 1955, which agreed that, "[i]n the

deposit liabilities by general usage." 49 Stat. 685-686 (emphasis added).

[18] A copy of this transcript has been lodged with the Clerk of the Court and provided to counsel.

[19] If the FDIC is required to treat unfunded standby letters of credit as deposits, it will be forced to collect additional annual insurance assessments in excess of $100 million. See page 28, *infra*.

context of deposit insurance * * * the only rational and relevant test" of whether a letter of credit represents a deposit "is whether the funds involved are those of the customer himself or funds of the bank which have been made available to the customer under a loan." 137 F. Supp. at 162.

Although the Corporation's interpretation was by then a long-standing one, Congress did not disturb Regulation I when, in 1950, it substantially overhauled the federal deposit insurance program. See Federal Deposit Insurance Act of 1950, ch. 967, 64 Stat. 873 *et seq.*; H.R. Rep. 2564, *supra*, at 5-13; S. Rep. 1269, *supra*, at 2-4. Indeed, Congress in 1960 *incorporated* Regulation I's language concerning letters of credit and promissory notes directly into what is now Section 1813(*l*)(1). See S. Rep. 1821, *supra*, at 10. Although the FDIC's general regulatory approach was called to the attention of Congress at that time (see *Federal Deposit Insurance Assessment: Hearings on H.R. 12465 Before the Senate Comm. on Banking and Currency*, 86th Cong., 2d Sess. 50 (1960) (statement of William G. Loeffler); *Federal Deposit Insurance Act: Hearings on H.R. 8916 and H.R. 8928 Before the Subcomm. of the House Comm. on Banking and Currency*, 86th Cong., 2d Sess. 112-113 1960) (statement of Royal L. Coburn, citing *FDIC* v. *Irving Trust Co.*, *supra*)),[20] absolutely nothing in the legislative history of the 1960 amendment expresses congressional dissatisfaction with, or an intent to depart from, the FDIC's application of Regulation I. To the contrary, the

[20] Indeed, at the time that Congress enacted Section 1813(*l*)(1) in 1960, FDIC regulations provided that a note (whether or not denominated a "promissory note") backing only a *commitment* to advance funds did not create a deposit. 12 C.F.R. 327.145, 327.148 (1959).

1960 legislation was designed principally to simplify the determination of assessments owed by FDIC-insured banks. See S. Rep. 1821, *supra*, at 1.

This legislative background strongly suggests that Congress affirmatively intended to endorse the FDIC's treatment of unfunded standby letters of credit: "once an agency's statutory construction has been 'fully brought to the attention of the public and the Congress,' and the latter has not sought to alter that interpretation although it has amended the statute in other respects, then presumably the legislative intent has been correctly discerned." *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979). See *Lorillard* v. *Pons*, 434 U.S. 575, 580-581 (1978). And Congress did more here than decline to disturb the agency's views; it actually incorporated those views into the statute.[21] Cf. *Bob Jones University* v. *United States*, 461 U.S. 574, 601-602 (1983).

At the very least, the factors at work here present the clearest imaginable case for deference to the FDIC. The Corporation developed the statutory lan-

[21] Congress very recently affirmed its long-settled view that standby letters of credit are not insured deposits within the meaning of Section 1813(*l*)(1). The Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 *et seq.*, provides that industrial revenue bonds lose their tax exempt status if they are "invested (directly or indirectly) in federally insured deposits." § 622, 98 Stat. 919. A bond is not viewed as federally guaranteed, however, "solely because a financial institution guarantees repayment of the loans [to financial institutions] other than by means of federal deposit insurance (*e.g.*, by a letter of credit)." Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 941 (Comm. Print 1984). Thus, it is still the congressional view that standby letters of credit (that is, those used to guarantee payment) are not federally insured.

guage (see *Miller* v. *Youakim*, 440 U.S. 125, 144 (1979)); the interpretation at issue involved a contemporaneous construction of that language (see *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978)) that has been followed for 50 years; Congress has expressed no dissatisfaction with the Corporation's approach, despite congressional amendment of the controlling statute (see *Lorillard*, 434 U.S. at 580-581); and, of course, Section 1813(*l*)(1) is a central portion of a complex regulatory scheme that the FDIC is charged with administering (see *Board of Governors* v. *Investment Company Institute*, 450 U.S. 46, 56 & n.21 (1981)). In these circumstances, the court of appeals could appropriately have rejected the FDIC's approach only if it found "compelling indications that [the approach] is wrong." *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969). Even the most cursory examination of the legislative background, however, demonstrates that the FDIC's interpretation of the statute is the only one that is faithful both to the statutory language and to the congressional purpose.

C. Both Congress And The Banking Industry Have Relied On The FDIC's Reading Of 12 U.S.C. 1813(*l*)(1)

Given the lengthy pedigree and previously unchallenged nature of the FDIC's interpretation of Section 1813(*l*)(1), it is not surprsing that the Corporation, the banking industry, and Congress itself have demonstrated "substantial reliance" on the FDIC's views. *Zenith Radio Corp.*, 437 U.S. at 457. Because the FDIC never has assessed insurance premiums on the approximately $120 billion in outstanding unfunded standby letters of credit, the decision below (to the extent that it would treat all such letters as repre-

senting insured deposits) would increase the aggregate domestic deposits held by FDIC-insured banks by some 8%, while proportionately reducing the ratio of the FDIC's insurance fund to deposits outstanding.[22] Moreover, because bank failures are not an altogether uncommon occurrence,[23] a decision that permits additional creditors to make insurance claims can be expected to impose significant new demands on the FDIC.

While aspects of this problem may be ameliorated over time through the payment by insured banks of increased insurance premiums to the FDIC, those premium adjustments in turn would impose significant, unexpected, and disruptive burdens on banking institutions. The FDIC generally assesses contributions to its insurance fund at 1/12 of 1% of a bank's deposits (see 12 U.S.C. 1817(b)); given the current volume of unfunded standby letters of credit outstanding, the FDIC would be forced to collect additional annual assessments in excess of $100 million if those letters were treated as deposits. Indeed, the FDIC's discretionary authority to charge back assessments for up to a five-year period (see 12 U.S.C. 1817(g)) could make banks liable for a one-time payment (including interest) of close to $400 million. By thus increasing the cost of standby letters of credit, this development could put American banks at a serious disadvantage vis-a-vis foreign or other

[22] The figures estimating the amounts involved have been provided to us by the FDIC, and are derived from its annual reports and published statistics on banking, and from call reports submitted to the FDIC by banking institutions.

[23] The FDIC reports that in the years 1982-1984 there were 179 bank failures in the United States. Through November, there were 108 bank failures in 1985.

non-insured institutions in arranging standby letter of credit transactions. See, *e.g.*, Quint, *Bank Credit Rulings Cause Concern*, N.Y. Times, Feb. 18, 1984, at D1.[24] This sort of effect—which was entirely disregarded by the court of appeals—plainly counsels that "the longstanding administrative construction of the statute should 'not be disturbed except for cogent reasons'" of a sort that have not been advanced here. *Zenith Radio Corp.*, 437 U.S. at 457-458, quoting *McLaren* v. *Fleischer*, 256 U.S. 477, 481 (1921). See *Udall* v. *Tallman*, 380 U.S. 1, 18 (1965).

Equally as significant, Congress has legislated with the FDIC's reading of Section 1813(*l*)(1) in mind. As noted above (note 21), the Deficit Reduction Act of 1984 provides that so-called industrial revenue bonds—which include many municipal bonds—are exempt from federal tax unless they are guaranteed by the federal government. When it enacted this provision, Congress expected that bonds would not be viewed as federally-guaranteed, and thus would not lose their tax exempt status, simply because they are backed by a guarantee (that is, a standby) letter of credit. See Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 941 (Comm. Print 1984). Yet the decision below sug-

[24] In addition, depending upon the required accounting method, treating standby letters of credit as deposits could increase bank capital requirements. FDIC-insured banks are required to maintain a minimum level of capital as a ratio to assets. If banks must carry standby letters of credit on their books as deposits, total bank assets will be increased; as a result, banks will be required to carry additional capital. See generally 50 Fed. Reg. 11128 (1985), to be codified at 12 C.F.R. Pt. 325. The FDIC estimates that, in the aggregate, this development could increase bank capital requirements by as much as $6.5 billion.

gests that the many billions of dollars worth of such bonds that are backed by standby letters of credit (see Quint, *supra*, at D4) may be viewed as federally-guaranteed and therefore as not tax exempt.[25] The court of appeals' ruling thus threatens to disturb both the expectations of bondholders and the scheme created by Congress.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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DECEMBER 1985

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[25] The Internal Revenue Service has announced that it will give "grandfather" tax exempt status to all standby letter of credit industrial revenue bond transactions completed within 120 days of the Court's decision in this case. IR-85-113 (Nov. 27, 1985).

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JOINT

APPENDIX

Supreme Court, U.S.
FILED
DEC 27 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1972

In the Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION, PETITIONER

v.

PHILADELPHIA GEAR CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

JOINT APPENDIX

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PETITION FOR WRIT OF CERTIORARI FILED JUNE 19, 1985
CERTIORARI GRANTED OCTOBER 21, 1985

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Relevant Docket Entries	1
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Promissory note dated April 23, 1981, executed by Orion Manufacturing Corp.	27
Order Allowing Certiorari	31
The following opinions have been omitted in printing this Joint Appendix because they appear on the following pages in the appendix to the printed Petition for Certiorari in No. 84-1972:	
Opinion of the court of appeals, issued December 27, 1984	1a
Opinion of the district court, issued February 9, 1984	20a
The following judgment and order have been omitted in printing this Joint Appendix because they appear on the following pages in the appendix to the printed Petition for Certiorari in No. 84-1972:	
Judgment of the court of appeals, issued February 9, 1984	44a
Order of February 19, 1985, denying petitioner's petition for rehearing and suggestion for rehearing en banc	46a

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 84-1901

PHILADELPHIA GEAR CORPORATION,
PLAINTIFF-APPELLANT
CROSS-APPELLEE

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its official capacity as Receiver of Penn Square Bank, N.A., and FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its corporate capacity, DEFENDANTS-APPELLEES, CROSS-APPELLANTS

RELEVANT DOCKET ENTRIES

DATE	FILINGS—PROCEEDINGS
6/28/84	CS.DKT. Case docketed
	ROA.DUE. Record on appeal due 6/28/84
	DKT.ST.DUE. Docketing statement due 7/9/84
7/3/84	DKT.ST.F Appellant's docketing statement filed, orig + 7cc, c/s
7/12/84	NAPR.F Notice of appearance filed by Rogers and Haught as attorneys for appellant
7/13/84	ROA.DUE. Record on appeal due 7/8/84, per Cross Appeal
7/16/84	NAPR.F Notice of appearance filed by Vogt and Plourde as attorneys for appellees.

DATE	FILINGS—PROCEEDINGS
7/27/84	ROA.RET.D.C. Record on appeal retained in D.C. per request by Judge McKay (See letter of 7/25/84.)
8/1/84	O.ASGN.CAL Order assigned to Calendar B disposed of by Seth. Parties served by mail.
	O.RMK Briefing of this appeal is to be expedited for argument and submission of the cases during the September 1984 Term of Court disposed of by Seth.
	O.BR.DUE Appellant's brief due 8/16/84 disposed of by Seth.
	O.BR.DUE Appellee's brief due 8/30/84 disposed of by Seth.
	O.RMK Appellant may file a reply brief on or before 9/6/84 and appellee may file its reply brief on or before 9/13/84. Counsel will be notified of the exact date and time for argument disposed of by Seth. Parties served by mail.
8/3/84	NAPR.F. Notice of appearance filed by Slattery & Stuart as attorneys for appellees, Philadelphia Gear Corp.
	R.RMD.CS.F Appellant's motion to partially remand case to district court filed, orig + 3cc, c/s
	M.RM.CS.SUBM Appellant's motion to partially remand case to district court submitted to panel
	M.EXTM.BR.F Plaintiff-appellant-appellee's (Philadelphia Gear Corp.) motion for extension of time to file original brief and reply brief filed (to 9/6/84 for original brief & to 9/27/84 for reply briefs) ; Orig. & 3cc., c/s.

DATE	FILINGS—PROCEEDINGS
8/7/84	M.EXTM.BR.SUBM Plaintiff-appellant-appellee's (Philadelphia Gear Corp.) motion for extension of time to file original brief and reply brief submitted to panel.
8/7/84	RHG.SET.SEPT '84 TERM, DENVER
8/9/84	M.VAC.HRG.F Appellee's (FDIC) motion to vacate oral argument from September 1984 Term of Court filed, Orig. & 3cc., c/s.
8/13/84	M.VAC.HRG.SUBM Appellee's (FDIC) motion to vacate oral argument from September 1984 Term of Court submitted to panel.
8/15/84	M.VAC.HRG.DISP Denied appellee's (FDIC) motion to vacate oral argument from September 1984 Term of Court disposed of by Seth. Parties served by mail.
8/16/84	BR.F. Appellant-Cross-Appellee's brief filed, orig. & 9cc., c/s.
9/4/84	BR.F Appellee's brief filed, Orig. & 10cc., c/s
9/6/84	BR.F. Appellant/Cross-Appellee's (Phil.Gear) reply brief filed. 0&9 c/s/
*9/4/84	NAPR.F Notice of appearance filed by Baker and Bryant as attorneys for appellee FDIC
9/13/84	BR.F/SUBM Appellant's reply brief filed, orig +9cc, c/s, and submitted to panel
	RMK.F/SUBM Appellant's errata sheets to opening brief filed, orig +9cc and submitted to panel
9/14/84	CS.ARG.SUBM—case argued and submitted—Doyle, McWilliams, Logan
9/26/84	ROA.F. Record on appeal filed, Vol I-III (pleadings) 861pp; IV-V (exhibits), Vol VI (transcript) 114pp; orig

DATE	FILINGS—PROCEEDINGS
11/15/84	ADD.AUTH.F/SUBM. Appellant's additional authority filed & submitted to panel. (orig. & 2cc, c/s
11/28/84	ADD.AUTH.RES.F/SUBM Appellee's response to appellant's additional authority filed, and submitted to panel
12/7/84	ADD.AUTH.F/SUBM. Appellant's additional authority filed (12/6/84) and submitted to panel. (orig. & 3cc, c/s)
12/10/84	ADD.AUTH.F/SUBM Appellee's additional authority filed, orig +3cc, c/s and submitted to panel
12/27/84	OPN.F Published, signed opinion filed—Doyle, McWilliams, Logan. Writing Judge is Logan. (parties served by mail)
	JM.DISP Judgment is affirmed in part; reversed in part; remanded.
1/11/85	P.REHG.ENB.F/SUBM. Appellee's/Cross-Appellant's (FDIC) untimely petition for rehearing en banc received but not filed. O&10 c/s—and submitted to panel.
1/14/85	RMK.F/SUBM. Appellee's/Cross-appellant's (FDIC) corrected page 11 of petition for rehearing en banc filed. O&10 c/s—and submitted to panel.
2/4/85	RMK.F./SUBM. Statement by Sullivan & Cromwell (not parties to appeal) in support of FDIC's petition for rehearing en banc—rec'd but not filed 0&9 c/s and submitted to panel
2/19/85	P.REHRG.ENB.DISP. Denied appellee's/cross-appellant's (FDIC) petition for rehearing en banc. En banc panel. Parties notified by mail.
2/27/85	MDT.ISS. Mandate issued to district court.

DATE	FILINGS—PROCEEDINGS
3/1/85	ROA.RTN.DC Record on appeal returned to district court (Vol I-VI)
3/7/85	MDT.RCPT.F Mandate receipt filed.
3/19/85	ROA.RCPT.F Record receipt filed
7/3/85	P.WRIT.CERT.F Appellees petition for writ of certiorari filed 6/19/85. Supreme Court No. 84-1972
10/25/85	P.WRIT.CERT.DISP. Granted appellant's petition for writ of cert on 10/21/85.
12/4/85	CERT.RMK. Request for record from supreme court.
12/5/85	CERT.REC.TRMT.SC. Certiorari record transmitted to Supreme Court:
	Page 1 Caption (84-1901/84-2007)
	page 2 Record on Appeal (by reference) (D.C. requested to send)
	Page 3 Submission Order
	Page 4 Opinion
	Page 5 Judgment
	Page 6 Order denying rehearing
	Page 7 Mandate
	Page 8 Clerk's Certificate

UNITED STATES COURT OF APPEALS
TENTH CIRCUIT

No. 84-2007

PHILADELPHIA GEAR CORPORATION,
PLAINTIFF-APPELLANT
CROSS-APPELLEE

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its official capacity as Receiver of Penn Square Bank, N.A., and FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its corporate capacity, DEFENDANTS-APPELLEES, CROSS-APPELLANTS

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7/19/84	DKT.ST.F. Appellant's docketing statement filed. O&6 c/s
7/27/84	ROA.RET.DC. Record on appeal retained in D.C. per request by Judge McKay (See letter of 7/25/84.)
7/31/48	NAPR.F. Notice of appearance filed by Haught as atty. for appellee.
8/1/84	O.ASGN.CAL Order assigned to Calendar B disposed of by Seth. Parties servee [sic] by mail.

DATE	FILINGS—PROCEEDINGS
	O.RMK Briefing of this appeal is to be expedited for argument and submission of the cases during the September 1984 Term of Court disposed of by Seth.
	O.BR. DUE Appellant's brief due 8/16/84 disposed of by Seth.
	O.BR.DUE Appellee's brief due 8/30/84 disposed of by Seth.
	O.RMK Appellant may file a reply brief on or before 9/6/84 and appellee may file its reply brief on or before 9/13/84. Counsel will be notified of the exact date and time for argument disposed of by Seth. Parties served by mail.
	FOR FURTHER DOCKET ENTRIES, SEE 84-1901

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF OKLAHOMA

No. CIV-82-1191-W

PHILADELPHIA GEAR CORPORATION, PLAINTIFF

v.

FEDERAL DEPOSIT INSURANCE CORPORATION, a national corporation, in its official capacity as Receiver of Penn Square Bank, N.A., and DEPOSIT INSURANCE NATIONAL BANK OF OKLAHOMA CITY, a national banking association, DEFENDANTS

RELEVANT DOCKET ENTRIES

DATE	NR	PROCEEDINGS
10-04-82		COMPLAINT
10-04-82		PRAECIPE for and issued 3 summons
10-11-82		PRAECIPE for & iss'd summons
10-31-82		PRAECIPE for & iss'd alias summons
10-31-82		ATTORNEY'S ret re summons & compl (4) Executed on William French Smith, Atty. Gen., cert mail, 8-9-82 (60 days) Executed on FDIC, cert mail, 8-18-82 (60 days) Executed on Deposit Ins. Nat'l Bank, cert mail, 8-18-82 (60 days) Executed on William S. Price, USA, personally 8-31-82 (60 days)

DATE	NR.	PROCEEDINGS
11-15-82		ANSWER of dfts Federal Deposit Ins. Corp. & Deposit Ins. Nat'l Bank to plf's compl-ws
12-29-82		INTERROGATORIES propounded by plf to dfts—ws
01-18-83		ORDER setting status/disc conference on recently assigned cases w/tlr (West) cc: att
01-18-83	*	PRETRIAL/STATUS DOCKET, 2-2-83, 9:50 a.m. (West) rw
01-31-83		OBJECTION to interrogs, by FDIC & Deposit Ins. Nat'l Bank—ws
02-02-83		JOINT status/disc rpt
02-03-83		ENTER Pretrial. Parties state contentions; dft to file brief w/in 45 days re MSJ; plf to resp 15 days t/a; suppl P.T. to be set May, 1983; dft to file brief in supp of obj to interrogs if parties cannot work it out w/in 10 days; brief to be filed w/in 5 days t/a if not worked out (Howland) rw
02-16-83		APPLICATION for enlarg of time in which to file mtn for S. J., by dfts—ws
02-18-83		ORDER dfts are hereby grtd an addl 15 days fm 3-17-83 w/in which to file a mtn for S. J. (West) rw
03-01-83		APPLICATION for enlarge of time in which to file mtn for S. J., by dft Deposit Ins Nat'l Bank—ws
03-01-83		MOTION for S. J. of FDIC—ws
03-01-83		BRIEF of FDIC in supp of mtn for S. J.—ws
03-05-83		ORDER dft Deposit Ins. Nat'l Bank should be & is hereby grtd an addl 10 days fm 4-1-83 w/i which to file a mtn for S. J. (West) rw

DATE	NR.	PROCEEDINGS
03-05-83		MOTION to compel ans to interrogs, for contempt of ct, & for atty fees & costs, by plf—ws
03-05-83		MEMORANDUM in supp of plf's mtn to compel ans to interrogs, for contempt of ct, & for atty fees & costs—ws
03-11-83		MOTION for SJ of FDIC, on behalf of Deposit Ins. Nat'l Bank—ws
03-11-83		BRIEF of FDIC, in its corporate capacity on behalf of Deposit Ins Nat'l Bank in supp of mtn for SJ—ws
03-11-83		NOTICE by dfts of taking depos—ws
03-11-83		PRAECIPE for & issd subp for Doug Reeves & Orion Mfg. Corp., on behalf of FDIC
03-15-83		DEFENDANTS' Answer Brief to Plf's Mtn to Compel Ans to Interrogs, for Contempt of Ct & for Atty Fees & Costs—-ws
03-18-83		PROCESS server's ret re subp d/t Executed on John Pitts personally, 4-18-83 Executed on Doug Reeves personally, 4-18-83
03-19-83		MOTION for Ext of Time to Resp to Mtn for SJ, by plf, w/ORDER that plf be & the same is hereby grtd on addl 30 days, until 5-15-83 w/i which to file its opposi to the Mtn for SJ filed by dft FDIC (West) rw
04-19-83		ORDER setting status/disc conf on recently assigned cases (West) rw
04-19-83		PRETRIAL/STATUS DOCKET, 5-5-83, 10:50 a.m. (West) rw
04-20-83		PRAECIPE for & issd subp for Orion Mfg., on behalf of FDC

DATE	NR.	PROCEEDINGS
04-21-83		ATTORNEY'S ret re depo subp Executed on Herbert Kenney personally 4-21-83
05-06-83		ENTER Order plf's mtn to compel is denied, because its interrogs are so broad that ans them would be egregiously burdensome; however, plf may narrow its interrogs & resubmit them w/in 15 days; second, plf's mtn for contempt & for sanctions arising out of dfts' alleged contumacious conduct is also denied at this time, but the Ct retains the right to reexamine this mtn later, if the need occurs (WEST) rw
05-19-83		APPLICATION FOR Ext of Time in which to resubmit interrogs, by plf—ws
05-10-83		AMENDED Compl—ws
05-05-83		ENTER PT. Plf grtd lv to file amend compl w/i 5 days; dft to file amend ans w/i 15 days; disc completion date 7-1-83; case to be on July NJ dkt (WEST) rw
05-16-83		MEMORANDUM of Plf in Oppos to Mtn of FDIC for SJ—ws
05-02-83		MOTION for Ext of Time to Resp to Mtn for SJ, by plf w/ORDER that plf is hereby grtd an addl 30 days, until 5-26-83, in which to file its oppos to the Mtn for SJ filed by dft DINB (WEST) rw
05-17-83		ANSWER to Plf's Amend Compl by FDIC—w/s
05-30-83		MOTION to Compel Attendance at Depo & Produce Docs and/or Sanctions; Mtn for Continuance of taking depo & of trial setting, by dfts—w/s

DATE	NR.	PROCEEDINGS
06-19-83		ORDER plf is grtd an ext of time of 10 days, to & includ 6-2-83, w/i which to narrow & resubmit its interrogs to dfts (WEST) rw
O6-26-83		MEMORANDUM of plf in Oppos to Mtn of FDIC in its Corporate Capacity on behalf of Deposit Ins. Nat'l Bank for SJ—ws
06-27-83		APPLICATION for Lv to File Brief in Reply to Plf's Resp to Dft's Mtn for SJ—w/s
06-31-83		ORDER that dft should be & hereby is grtd lv to file a brief in reply to plf's resp to dft's mtn for SJ, on or beofre 6-10-83 (West) rw
06-09-83		APPLICATION for Lv to File Brief to Plf's Resp to Dft's Mtn for SJ—w/s
06-10-83		BRIEF of FDIC, Receiver of Penn Square Bank, N.A., in Reply to Plf's Resp to Mtn for SJ—w/s
06-10-83		ORDER that dft should be & is hereby grtd lv to file a brief in reply to plf's Resp to dft's Mtn for SJ on or before 7-7-83 (WEST) rw
06-23-83		MOTION for Lv to File Reply Memo, by plf, w/ORDER plf is hereby grtd until 7-1-83 w/i which to file a reply memo (WEST) mlc
06-23-83		TRIAL Order (WEST) cc: cnsl
06-23-82	*	NONJURY DOCKET, 7-20-83, 9:00 a.m. (WEST) rw
06-24-83		NOTICE to Take Depo, by dft FDIC—w/s
07-01-83		APPLICATION for Protective Order, by FDIC —w/s
07-01-83		ORDER dfts will produce the docs requested in para 1, 2, & 3 of plf's doc request; that plf shall take care not to allow the disclosure of the docs produced by dfts or contents thereof; docs produced by dfts shall not be filed or record, nor contents disclosed in any doc filed of record unless submitted in a sealed envelope to be opened by this Ct; all questions re relevancy or admissibility of the docs produced by dfts are expressly reserved for determination at the time such are offered as evid; plf shall destroy all docs produced at the termination of these proceedings or shall return them to dfts at that time (WEST) mdb

DATE	NR.	PROCEEDINGS
07-01-83		REPLY Memo of Plf in Oppos to Mtn of FDIC for SJ—w/s
07-05-83		ITEMS of Doc Evid as to which There are no Objs & which May be Admitted w/o Formal Proof, by plf—w/s
07-05-83		PLAINTIFF'S Suggested FofF&CofL—w/s
07-05-83		PRETRIAL Memo of Plf—w/s
07-05-83		PLAINTIFF's Wit List—w/s
07-05-83		BRIEF in Supp of Dfts' Objs to Plf's Interrogs —w/s
07-06--83		APPLICATION for Protective Order, by dfts —w/s
07-05-83		ORDER that this Ct's order of 6-23-83 be ext for a period of 30 days, until 7-22-83, & that the case be strkn fm the July trial dkt (WEST) mdb
07-07-83		BRIEF of FDIC in its Corporate Capacity, in Reply to Pif's Resp to Mtn for SJ—w/s
07-18-83		MEMORANDUM in Oppos to Mtn to Compel Attendance at Depo & to Produce Docs and/ or Sanctions, by plf—-w/s

DATE	NR.	PROCEEDINGS
07-18-83		REPLY Memo of Plf in Oppos to Mtn of FDIC in its Corporate Capacity on Behalf of Deposit Ins Nat'l Bank for SJ—w/s
07-18-83		MOTION in Limine for Ruling on Admissibility of Evidence, by plf—w/f
07-18-83		MEMORANDUM in Supp of Mtn in Limine for Ruling on Admissibility of Evid, by plf—w/s
07-18-83		MOTION for SJ, by plf—w/s
07-18-83		MEMORANDUM in Supp of Mtn for SJ, w/ exhbs attached, by plf—w/s
07-18-83		ORDER that dfts will resp to Interrog No. 2 of plf's interrogs; that info will not be disclosed to anyone other than plf or its attys; info shall not be filed of record unless submitted in a sealed envelope to be opened by the Ct; all questions re relevancy or admissibility of the info are expressly reserved for determination at the time the docs are offered as evid; plf shall destroy all docs containing the info provided at termination of these proceedings (WEST)
07-21-83		MOTION to Compel Production, or in the Alternative, to Conduct an in camera inspection of Docs, by plf—w/s
07-21-83		BRIEF in Supp of Plf's Mtn to Compel Production of Docs or, in the Alternative, Conduct an in camera Inspection of Docs—w/s
07-22-83		DEFENDANTS' Obj to Plf's Reply Memo Brief in Opposto Mtn of FDIC on behalf of DINB—w/s
07-22-83		DEFENDANTs' Appl for Ext of Time w/i which to ans the Request for Admis of plf—w/s

DATE	NR.	PROCEEDINGS
07-25-83		BRIEF of FDIC in Reply to Plf's Memo in Oppos to Mtn to Compel w/LV GRTD to file (WEST)—w/s
07-25-83		ORDER dfts are grtd an addl 20 days w/i which to ans the req for adms submitted plb (WEST) rw
07-27-83		BRIEF in Supp of Dfts' Objs to Plf's Request for Production of Docs—w/s
08-01-83		PLAINTIFF'S Mtn to W/drw Mtn to Compel Production, or in the alternative, to Conduct an in camera Inspection of Docs—w/s
08-02-83		BRIEF in Resp to Plf's Mtn in Limine, by dfts—w/s
08-02-83		APPLICATION for Enlarg of Time w/i which to Resp to Plf's Mtn for SJ, by dfts—w/s
08-02-83		ORDER that plf's Mtn to W/drw Mtn to Compel Production, or in the Alternative, to Conduct an in camera inspection of docs is hereby grtd (WEST) rw
08-04-83		ORDER that dfts should be & are hereby grtd an addl 15 days fm 8-2-23 w/i which to resp to plf's Mtn for SJ (WEST) rw
08-11-83		TRIAL Brief of FDIC—w/s
08-12-83		REPLY Memo of Plf in Supp of Mtn in Limine for Ruling on Admissibility of Evid—w/s
08-16-83		BRIEF in Resp to Plf's Mtn for SJ, by dfts—w/s
08-16-83		PLAINTIFF's Suggested FofF&Cofl, underscored
08-17-83		ENTER ORDER: Ptys are hereby notified that case is set at the heel of Sept NJ dkt, said dkt commencing 9-12-83; ptys are direct to appear for dkt call at 9:00 a.m., 9-12-83 (WEST) rw

DATE	NR.	PROCEEDINGS
08-17-83		APPLICATION for Ext of Time to file their lists of witns & exhbs, by dfts—w/s
08-17-83		STIPULATION for Entry of Order, by dfts—w/s
08-17-83		ORDER that Deposit Ins Nat'l Bank shall be dism fm this action; that FDIC in its corporate capacity shall be substituted in place of Deposit Ins Nat'l Bank & shall adopt all pldgs & mtns filed on behalf of Deposit Ins Nat'l Bank (WEST (COB #160) (ENTERED: Clerk) rw cc: cnsl
08-18-83		ORDER—that dfts grtd an ext of time w/in which to file their list of witns & e & that such time be ext until further order of court (WEST) rw
08-30-83		ORDER both dfts' mtn to compel & plf's mtn in limine are grntd in part & denied part; plf's depo shall be conducted by telephone; at or before that depo, plf shall produce to dfts any unprivileged docs re disputed letter of credit; ptys are grtd an ext of time until 9-19-83 in which to file their lists of wits & exhbs; this action remains on the heel of Sept NJ dkt (WEST) rw
09-07-83		PLAINTIFF'S Suppl Trial Memo—w/s
09-07-83		DEFENDANT'S Proposed FofF&CofL, underscored
09-13-83		ORDER ptys' cross-mtns for SJ must be denied (WEST) rw
09-16-83		PRAECIPE for & issd subp for Harold D. Armstrong & William G. Patterson
09-19-83		LIST of wits & exhbs, by dft FDIC—w/s
09-19-83		LIST of Exhbs & Wits, by plf—w/s

DATE	NR.	PROCEEDINGS
09-20-83		ENTER NJ TRIAL: Parties announce ready; plf presents case in chief w/test of wits; plf's exhbs 1, 2, 3 admitted; Ct adjourns to 9:00 a.m., 9-21-83 (WEST) rw
09-21-83		ENTER FURTHER NJ TRIAL: Plf continues case in chief w/test of wits; plf's exhbts 4, 5A, B, C, 6, 7 8a thru E, 9 thru 18 admitted; dft's exhbs 1-4 admitted; plf rests; dft's mtn for dism denied; dft presents case in chief w/test of wits & rests; parties rest; case taken under advisement (WEST) rw
09-23-83		RETURN re serv of subp Executed on Harold Armstrong personally, 9-18-83 Executed on William G. Patterson personally, 9-18-83
10-04-83		REPORTER'S Transcript of Proceedings had Sept. 20 & 21, 1983 (Gill, Rptr)
10-27-83		POST-TRIAL Memo on behalf of Plf—w/s
10-27-83		JOINT Mtn of Plf & Dft for Ext of Time to File Reply Brfs
10-27-83		BRIEF of FDIC re Proceedings had 9-20-83—w/s
10-27-83		BRIEF of FDIC re Proceedings had Sept 21 & 22, 1983—w/s
10-28-83		ORDER that plf & dft be grtd an ext of time w/i which to file their post-trial reply brfs fm 11-3-83 to 11-10-83 (WEST) rw
11-10-83		BRIEF of FDIC in Response to Plf's Post-Trial Memorandum—w/s
11-10-83		REPLY Post-Trial Memo on Behalf of Plf, Philadelphia Gear Corporation—w/s

DATE	NR.	PROCEEDINGS
02-09-84	1	FINDINGS of Fact & Conclusions of Law (WEST) se
02-09-84	2	JUDGMENT in fvr of plf & agnst dft FDIC in its coporate capacity for $100,000.00 in deposit ins & agnst FDIC in its capacity as recvr for the bal of $45,200.00 in the form of a recvr's certificate; plf entitled to int, one, frm the FDIC in its corporate capacity frm the date of maturity of the credit & two frm the FDIC as recvr frm the date of the 1st distribution frm the estat of the failed bk; plf shall release to the FDIC the goods involved in the underlying transaction w/ Orion (at least up to a value of $145,200.00) (WEST) (COB #166) (ENTERED: Clerk) cc:cnsl—se
02-21-84	3	MOTION to Alter or Amend Judg by plf—w/s
02-21-84	4	MEMORANDUM in Supp of Mtn to Alter or Amend Judg—w/s
02-22-84	5	PLAINTIFF'S Mtn for Ext of Time to File Mtn for Atty's Fees & Bill of Costs—w/s
02-22-84	6	APPLICATION for Enlargment of Time by dfts—w/s
02-24-84	7	ORDER grtg dfts 15 days w/i which to file Bill of Costs & appl for atty's fees (WEST) rw
02-24-84	8	ORDER grtg plf ext of time to file mtn for atty's fees & bill of costs; mtn for atty's fees & bill of costs must be filed 15 days of the date of the Ct's ruling on plf's pending mtn to alter or amend judg (WEST) rw
02-24-84	9	MOTION To Assess Atty's Fees & Brf In Support Thereof by plf—w/s
02-24-84	10	BILL of Costs of plf in the amt of $1,512.10 agnst dft

DATE	NR.	PROCEEDINGS
02-24-84	11	PLAINTIFF'S Brf In Supp of Bill of Costs—w/s
03-06-84	12	APPLICATION For Enlg of Time w/in which to file brfs In Response to Mtn to Alter Or Amend Judg by dft—w/s
03-08-84	13	ORDER grtg dfts an addl 10 days fm 3/2/84 to file brfs (WEST) rw
03-12-84	14	DEFENDANTS' Objections to Plfs' Bill of Costs by dfts—w/s
03-12-84	15	RESPONSE To Plf's Mtn to Assess Atty's Fees &/Or Altn Dft's Mtn to Assess Atty's Fees—w/s
03-16-84	16	PLAINTIFF'S Motion For Lv To File Reply To Dft's Response to Plf's Mtn to Assess Atty's Fees—w/s
03-19-84	17	BRIEF of FDIC In Ints [sic] Corporate Capacity, In Resp to Motion to Alter or Amend Judg
03-19-84	18	BRIEF of FDIC, Recvr of Penn Sq Bk, N.A., In Resp to Mtn to Alter Or Amend Judg—w/s
03-19-84	19	ORDER grtg plf lv to file a reply to the dft's resp to plf's mtn to assess atty's fees (WEST) rw
03-19-84	20	PLAINTIFF'S Reply To Dft's Response to Plf's Mtn to Assess Atty's Fees—w/s
03-29-84	21	ORDER—re plf's mtn to assess attys fess; plf to supplement its mtns w/in 10 days dfts may w/in 10 days supplement their opposition to the mtn (WEST) rw
03-30-84	22	PLAINTIFF'S Mtn for Lv to File Reply to Dft's Resp to Plf's Mtn to Alter or Amend Judg—w/s

DATE	NR.	PROCEEDINGS
04-04-84	23	ORDER—grtg plf lv to file a reply to dft's brfs in resp to the plf's mtn to alter or amend judg on or before 4-6-84 (WEST) rw
04-03-84		COSTS Taxed in the amt of $1,512.10 agnst dft FDIC (Clerk) fb
04-06-84	24	REPLY Memorandum In Supp of Mtn to Alter Or Amend Judg by plf--w/s
04-09-84	25	SUPPLEMENTAL Brf of FDIC Recvr of Penn Sq Bank, N.A. & FDIC In Its Corporate Capacity, In Opposition to Mtn to Assess Attys' Fees—w/s
04-09-84	26	PLAINTIFF'S Suppl Brf in Supp of Mtn to Assess Atty Fees—w/s
04-19-84	27	APPLICATION For Lv to File A Reply Brief by dfts—w/s
04-19-84	28	ORDER grtg dft lv to file a brf in reply to plf's suppl brf in supp of mtn to assess atty's fees (WEST) cl
04-19-84	29	BRIEF of FDIC, Recvr of Penn Sq Bk, N.A. & FDIC, In Its Corporate Capacity, In Reply to Plf's Suppl Brf—w/s
05-17-84	30	ORDER: Plaintiff's motion for Modification of Judgment is GRANTED in part, DENIED in part; Motion for attorney's fees is DENIED. (WEST) rw
5/17/84	31	AMENDED JUDGMENT: Plaintiff's Motion to alter judgment is GRANTED $100,000 against FDIC in capacity as receiver for the balance of $45,200.00 in the form of receiver certificate, with interest. Plaintiff shall release to FDIC the goods involved in the underlying transaction with Oion (value at least $145,200. (WEST) rw (Micro 5/84) ENTERED by Clerk

DATE	NR.	PROCEEDINGS
6/5/84	32	LETTER to Judge West re: disposition of various cases with respect to decision in Philadelphia Gear case, from Atty. Burns Hargis
06-18-84	33	NOTICE of appeal by plf fm amend judgm entered 5-17-84—w/s
06-18-24		RECEIVED $70.00 filing & dktg fee. Receipt #34925
06-25-84	34	CLERK'S ltr re service of notice of appeal, w/cpy ltr, notice & dkt sheet to cns & CCA—mlc #84-1901
06-28-84	35	NOTICE of Transcript Order, transcript already on file—cc: cnsl & CCA
06-28-84	36	NOTICE of appeal by dft FDIC fm judgm entered 5-17-84—w/s # 84-2007
06-28-84		RECEIVED $70.00 filing & dktg fee. Receipt #35167
07-05-84	37	CLERK's ltr re service of notice of appeal, w/cpy ltr, notice & dkt sheet to cns & CCA—mlc
07-25-84	38	CLERK'S ltr to Howard K. Phillips, Clerk, Tenth Circuit Court of Appeals, stating that the Record on Appeal and Transcript are complete for appeal purposes, 11(c), 11(e) and will be retained in this ct purs to instructions fm the Court of Appeals w/cert copies of Index & Dkt Sheet—cc: ltr & Index to cosl—mlc
09-24-84	39	CLERK'S ltr transmitting ROA to CCA w/cpy ltr, Index & cert. dkt sht to consl. (6 Vol.) jgs
03-01-85	40	CCA's Cpy Opinion Reversed in part & Affirmed in part. (12-27-84)

DATE	NR.	PROCEEDINGS
03-01-85	41	CCA's Cert Cpy Judgmt Cause Remanded for fur proceeds. (DOYLE MCWILLIAMS & LOGAN)
03-01-85	42	CCA's Receipt for Mandate. CCA#s 84-1901 & 84-2007. rs
03-29-85	43	MOTION For Amend Of Judg by plf—w/s
04-29-85	44	MEMORANDUM In Supp Of Mtn For Amend Of Judg by plf—w/s
05-09-85	45	APPLICATION For Ext Of Time by dft FDIC for addl 5 days w/i which to resp to mtn for amend of judg by plf-w/s
05-09-85	46	ORDER: FDIC grtd addl 5 days or until 5-14-85 w/i which to resp to plf's mtn for amend Judg. (WEST) lj
05-14-85	47	FEDERAL Deposit Ins Corp's Objection To Plf's Mtn For Amend Of Judg—w/s
05-30-85	48	SUPPLEMENTAL Memo In Supp Of Mtn For Amend Of Judg In Accord W/Mandate Of Ct of Appeals by plf—w/s
07-05-85	49	CCA's ltr adv petn for Writ of Cert was Filed 6-19-85 with the Supreme Ct & assign #84-1972; Record on Appeal to be retained intact until writ of Cert has been disposed of (Phillips, Clerk)—psh
10-28-85	50	ORDER in accordancw [sic] w/mandate of 10th Cir, this ct's amend judgmt of 5-17-84 shall be & is hereby modified to delet the award of any & all prejudgmnt int in plf's paymnt of deposit insur, ptys are instructed to prepare & submit w/10 days hereof a proposed judgmnt, agreed as to form, in accordance w/ Order (WEST) rw

DATE	NR.	PROCEEDINGS
10-28-85	51	LETTER of CCA advise that petition for writ of certiorari was grtd by an order of the Supreme Ct, dated 10-21-8t [sic] (Phillips)
12-09-85	52	LETTER (copy) of CCA addressed to Mr. Spaniol, Jr., Clk of US Supreme Ct re certiorari & advise Clk USDC WD to foward original record on appeal to U. S. Supreme Ct
12-11-85	53	CLERK'S Letter Transmitting Original Record on Appeal to US Supreme Court—cc: cnsl & CCA—jfs

PENN SQUARE BANK NA
P.O. Box 26208
Oklahoma City, Okla. 73126

THIS LETTER OF CREDIT REPLACES
LETTER OF CREDIT #0929
Date: April 23, 1981

IRREVOCABLE STANDBY LETTER OF CREDIT

All drafts must be marked:

"Drawn under Penn Square Bank
credit no. 1042

Advising bank reference no.

Advising bank

Penn Square Bank, N.A.
Post Office Box 26208
Oklahoma City, Oklahoma 73126

For account of

Orion Manufacturing Corporation
3000 United Founders Boulevard
Suite 108-G
Oklahoma City, Oklahoma 73112

To Beneficiary

Philadelphia Gear Corporation
King of Prussia, Pennsylvania 19406

Amount

One Hundred Forty-Five Thousand
Two Hundred and No/100 Dollars
$145,200.00

Expiration date

August 1, 1982

Gentlemen:

☐ This refers to preliminary cable advice of this credit.

We hereby establish our irrevocable letter of credit in your favor available by your drafts drawn at on Penn Square Bank, N.A. and accompanied by documents specified below:

(1) Your signed statement that you have invoiced Orion Manufacturing Corporation and that said invoices have remained unpaid for at least fifteen (15) days

(2) Copy of all invoices

(3) All invoices will be verified for authenticity and payment with Orion Manufacturing Corporation.

(4) We hereby agree with drawers, endorsers and bonafide holders of all drafts, drawn under and in compliance with the terms of this credit, that such drafts will be duly honored upon presentation to the drawer.

We hereby engage with you that all drafts drawn under and in compliance with the terms of this credit will be duly honored if drawn and presented for payment at this office on or before the expiration date of this credit.

Sincerely yours,

/s/ [Illegible]

Advising bank's notification

Bill Patterson
Executive Vice President

PENN SQUARE BANK na

May 6, 1981

Mr. Joe Pooler
Philadelphia Gear Corp.
King of Prussia, Pennsylvania 19406

Re: Letter of Credit #1042 for Orion Manufacturing Corporation

Dear Mr. Pooler:

Per your request, we hereby amend our Letter of Credit #1042 for the account of Orion Manufacturing Corporation as follows:

Delete paragraph number three (3):

"All invoices will be verified for authenticity and payment with Orion Manufacturing Corporation.

Add the following paragraph:

"This credit shall be automatically reinstated from time to time for any sum or sums up to $145,000.00 upon presentation of described documents. This credit and all reinstatements are irrevocable and shall expire on August 1, 1982."

If you need anything else, please call.

Sincerely,

/s/ [Illegible] for B.G.P.
BILL G. PATTERSON
Executive Vice President

BGP/jcl

cc: Harold Armstrong

PROMISSORY NOTE—COMMERCIAL, VARIABLE INTEREST RATE

Makers Name & Address

ORION MANUFACTURING CORP.
3000 United Founders Blvd.
Suite 108-G
Oklahoma City, OK 73112

Date of Note 4-23-81

Maturity Date 8-1-82

Principal Amount $145,200.0

Interest Rate, Payable at a Fluctuating Rate Per Annum
1% above Penn Square Bank Prime (floating) 19%

Interest Payable at maturity

Principal Payable at maturity

Renewal of #

☒ New Loan Letter of Credit #1042

Officer BGP

This is a single payment note with principal sum and accrued interest due at maturity

Collateral

Unsecured

Purpose of Loan if in Excess of $5,000

Back up Letter of Credit #1042—increasing current Letter of Credit #0929

For value received, the undersigned (the "Makers") agree to all the terms of this Note and promise to pay to the order of the Bank named below the Principal Amount, together with interest, all as set forth above. Installments of Principal and Interest are payable on the same day of the month as the First Installment. The unpaid balance of the Principal and Interest shall become payable on the Maturity Date, and any amount, not paid when due shall bear interest at a rate of 5% greater than the per annum interest rate set forth above.

Changes in the rate charged on this Note are effective without notice to Makers on the same day as the effective change in the base or prime rate as established from time to time by the bank named above unless a different rate is written or typed herein, provided, however, that in no event shall the interest charged hereunder exceed the maximum allowed by law.

This Note and all other obligations of Makers to holder, and all renewals and extensions thereof are secured by the collateral described herein, together with all other collateral heretofore or hereafter given Bank.

At the option of the holder, the unpaid balance of this Note, and all other obligations of Makers to the holder, whether direct or indirect, absolute or contingent, now existing or hereafter arising, shall become immediately due and payable without notice or demand upon the occurrence or existence of any of the following events or conditions: (a) Any payment required by this or any other note or obligation of Makers to holder or to others is not made when due; (b) Any default occurs in the performance of any covenant, obligation, warranty, or provision contained in any loan agreement or in any instrument or document securing or relating to this or any other note or obligation of Makers to holder or to others; (c) Any warranty representation, financial information, or statement made or furnished to Bank by or in behalf

of Makers proves to have been false in any material respect when made or furnished; (d) Any time Bank in its sole discretion believes that the prospect of payment of this Note is impaired.

All parties hereto shall each be regarded as a principal and each party agrees that any party hereto with the approval of the holder and without notice to the other parties may from time to time renew this Note or consent to one or more extensions or deferrals of the Maturity Date hereof or for any term or terms, and all parties shall be liable in the same manner as on the original note; and all parties hereto hereby waive presentment, notice of dishonor and protest, and consent to partial payments, substitutions or release of collateral and the addition or release of any party or guarantor.

It is specifically agreed that the sum of all the advances under this Note may exceed the Principal Amount as shown above, but the unpaid principal balance shall never exceed said Principal Amount. Advances and payments shall be recorded on the records of the Bank, and such records shall be prima facie evidence of said advances, payments and unpaid principal balance of this Note. Subsequent advances shall be at the Bank's option and the procedure described herein shall not be construed or interpreted as granting a continuing line of credit for the Principal Amount.

No waiver of any payment or other right under this Note or any related agreement shall operate as a waiver of any other payment or right. All parties agree to pay reasonable costs of collection, including an attorney's fee of 15% of all sums due upon default.

Any indebtedness due from the holder hereof to any party hereto including, without limitation, any deposits or credit balances or any other indebtedness due from holder is pledged to secure the payment hereof and any other indebtedness to holder of any other party hereto

and may at any time while the whole or any part of such indebtedness remains unpaid, whether before or after maturity hereof, be appropriated, held or applied toward the payment of this Note or any other indebtedness to holder of any party hereto.

This Note is to be construed, according to the laws of the State of Oklahoma.

ORION MANUFACTURING CORP.

By: /s/ Gary Gray
GARY GRAY
Chairman of the Board

PENN SQUARE BANK n.a.
1919 Penn Square
Oklahoma City, Oklahoma 73118

SUPREME COURT OF THE UNITED STATES

No. 84-1972

FEDERAL DEPOSIT INSURANCE CORPORATION, PETITIONER

v.

PHILADELPHIA GEAR CORPORATION

Filed October 21, 1985

ORDER ALLOWING CERTIORARI

The petition herein for a writ of certiorari to the United States Court of Appeals for the Tenth Circuit is granted.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1985 491507 20508

RESPONDENT'S

BRIEF

Supreme Court, U.S.
F I L E D
JAN 10 1988
JOSEPH F. SPANIOL
CLERK

NO. 84-1972

In the Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner

v.

PHILADELPHIA GEAR CORPORATION,
Respondent

ON WRIT OF CERTIORARI TO
THE UNITED STATES COURT OF APPEALS FOR
THE TENTH CIRCUIT

BRIEF FOR RESPONDENT

GERALD F. SLATTERY, JR.
Counsel for Respondent,
Philadelphia Gear Corporation
2350 Pan American Life Center
601 Poydras Street
New Orleans, Louisiana 70130
(504) 581-1636

GORDON, ARATA, MCCOLLAM,
STUART & DUPLANTIS
2350 Pan American Life Center
601 Poydras Street
New Orleans, Louisiana 70130

A B Letter Service, Inc., 327 Chartres St., New Orleans, La. (504) 581-5555

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QUESTION PRESENTED

Whether a standby letter of credit issued in exchange for a promissory note from the issuing bank's customer is a deposit within the meaning of 12 U.S.C. § 1813(*l*)(1).

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In The

Supreme Court Of The United States

OCTOBER TERM, 1985

No. 84-1972

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

v.

PHILADELPHIA GEAR CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS FOR
THE TENTH CIRCUIT

BRIEF FOR RESPONDENT

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit is reported at 751 F. 2d 1131. The opinion of the United States District Court for the Western District of Oklahoma is unreported.

STATUTE INVOLVED

The term "deposit" means —

(1) the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking,

savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or a draft drawn against a deposit account and certified by the bank, or a letter of credit or a traveler's check on which the bank is primarily liable: *Provided*, That, without limiting the generality of the term "money or its equivalent," any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a prommissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such banks for collection.

12 U.S.C. § 1813(*l*)(1) (1960).

STATEMENT OF THE CASE

Respondent, Philadelphia Gear Corporation ("Philadelphia Gear"),[1] is the beneficiary of Letter of Credit No. 1042, dated April 23, 1981 and amended May 6, 1981

1. The corporate parent, affiliates, and non-wholly owned subsidiaries of respondent are here listed pursuant to Supreme Court Rule 28.1. Respondent's parent corporation is American Manufacturing Corporation. Respondent's affiliate corporations are: American Insurance Corporation Services, Inc.; Limitorque Corporation (Virginia); American Manufacturing Co., Inc.; Rapid Gear Repair Co., Inc.; Lehigh Products, Inc.; and Effector, Inc. Respondent's non-wholly owned subsidiary is Philadelphia Gear de Mexico, S.A.

(Exhibit P-1, T.4, J.A. 24-26),[2] issued by Penn Square Bank, N.A., formerly a national banking association. The letter was issued by Penn Square Bank for the account of its customer, Orion Manufacturing Corporation ("Orion"), in exchange for Orion's promissory note (Exhibit P-15, T. 49, J.A. 27-30) in the face amount of the letter, to facilitate the sale of oil pump gear reducer drives from Philadelphia Gear to Orion.

On July 5, 1982, the Comptroller of the Currency declared Penn Square Bank insolvent and appointed the Federal Deposit Insurance Corporation ("FDIC") as receiver. On July 7, 1982, and again on July 22, 1982, Philadelphia Gear, through its remitting bank, submitted its drafts on the letter of credit (Exhibits P-5A through -5C and P-8A through -8C, T. 47, 48). All of these drafts complied with the terms and conditions of the letter of credit. District Court Findings of Fact No. 8 and No. 10, Conclusion of Law No. 13 (Feb. 9, 1984) (R. 738-39, 746).

On or about July 26, 1982, Phildelphia Gear received a letter from the FDIC (Exhibit P-7, T. 47-48) advising it that, as receiver for former Penn Square Bank, the FDIC disaffirmed "any and all terms, provisions, responsibilities or obligations that might otherwise exist" under Letter of Credit No. 1042, and that no drafts on the letter would be honored, because of the insolvency of Penn Square Bank. At about the same time, Philadelphia Gear's remitting bank received "return item notices" (Exhibits P-10 *in globo* and P-11 *in globo*, T. 48) from the FDIC stating that the drafts were being returned unpaid because of the insolvency of the issuing bank.

2. The notation "T" refers to Volume VI of the record, the transcript of the trial on September 20 and 21, 1983. The references are the page numbers in the transcript at which the designated exhibit was offered into evidence, and at which it was ruled upon by the district court. The Joint Appendix ("J.A."), wherein are reproduced the relevant docket entries, also contains Penn Square Bank's letter of credit (Exhibit P-1), at 24-26, and Orion's promissory note (Exhibit P-15), at 27-30.

Shortly thereafter, on August 4, 1982, Philadelphia Gear filed this action seeking recovery of $100,000 in cash from the FDIC in its corporate capacity, and the balance in a receiver's certificate from the FDIC in its capacity as receiver of the issuing bank. The case was tried on September 20 and 21, 1983. On February 9, 1984, the district court entered judgment in favor of Philadelphia Gear and against the FDIC in its corporate capacity for $100,000 in deposit insurance, holding that the letter of credit was an insured deposit under 12 U.S.C. § 1813 (*l*) (1),[3] and in favor of Philadelphia Gear against the FDIC in its capacity as receiver for the balance of the face amount of the letter.

The court of appeals affirmed the district court's holding that the standby letter of credit represented a deposit under 12 U.S.C. § 1813*(l)* (1). Rejecting the FDIC's argument that Orion's promissory note did not evidence the receipt of the equivalent of money since no advance had been made thereon before Penn Square Bank became insolvent, the court of appeals noted that the promissory note obligated Orion to repay with interest all advances made by the bank, in exchange for which the bank had issued a letter of credit to respondent. 751 F.2d at 1134. The court

3. Addressing the FDIC's contentions, the district court stated:

> The FDIC's arguments . . . are not convincing. The FDIC first attempts to distinguish Orion's promissory note from that which is within the compass of statutory definition by arguing that the note was merely a conditional debt, contingent on the letter's being called; that it was not a liability of Orion until that time; and that Penn Square Bank never considered it an asset. These arguments may be interesting, but they ignore the plain terms of the statute. . . .

Conclusion of Law No. 20 (Feb. 9, 1984) (R. 755-56). The district court held that the FDIC's argument that Penn Square Bank was not primarily liable on Letter of Credit No. 1042 was "without merit," as "a standby letter of credit is a direct, primary engagement of the issuing bank's credit, independent of the underlying transaction." *Id.* (R. 756).

also dismissed the FDIC's argument that the federal deposit insurance fund is structured so as to exclude standby letters of credit from coverage. *Id.* at 1137-38. The court noted that 12 U.S.C. § 1817(4), addressing the obligation of an insured bank to report its total liability in deposits, refers expressly to Section 1813*(l)* for the definition of "deposit." *Id.* at 1137. Holding that nothing in the language of the statute or its legislative history showed an intent by Congress to narrow the definition of a deposit to exclude standby letters, the court affirmed the district court's decision that the letter of credit issued to respondent was an insured deposit.

SUMMARY OF ARGUMENT

This case presents a simple question of statutory construction. The sole issue is whether a standby letter of credit, issued in exchange for a promissory note from the issuing bank's customer, is a deposit within the meaning of the Federal Deposit Insurance Act, 12 U.S.C. § 1811 *et seq.* The district court and the court of appeals, applying the plain language of the statute to the facts of the case, held that respondent's letter of credit is a deposit within the meaning of Section 1813*(l)*(1), and so is insured under Section 1813(m).

In cases where an agency's construction of a statute is at issue, the Court has repeatedly made clear that its analysis begins with the terms of the statute itself. The analysis goes no further if the statute is unambiguous and is within the constitutional authority of Congress. In such circumstances, the Court merely gives effect to the expressed intent of Congress. That is all that is required in this case.

The letter of credit issued to respondent is an irrevocable standby letter of credit, universally recognized by courts and commentators as one on which an issuing

bank is primarily liable. The letter was issued in exchange for the account party's promissory note: on its face, an unconditional promise to pay a sum certain in money within a specified time. Under the plain terms of the statute, because the letter of credit was issued in exchange for the note, the letter "must be regarded as evidencing the receipt of the equivalent of money." 12 U.S.C. § 1813(*l*)(1).

The position of the FDIC and those *amici curiae* who seek reversal of the decision below — that Section 1813 (*l*)(1) is intended to refer only to a letter of credit that is actually funded, in advance of the beneficiary's drafts on the letter — effectively reads out of the statute that portion of the proviso referring to promissory notes. "Funded" letters of credit (as that term has been used by the FDIC and its *amici*) will, depending upon the circumstances, either fit within the definition of "money or its equivalent" in Section 1813(*l*)(1) without reference to the proviso, or, if a special account is credited, represent insured deposits as "special purpose" funds under Section 1813(*l*)(3). Only by construing the proviso to cover promissory notes handled as Penn Square Bank handled Orion's in this case can the Court give effect to the entirety of Section 1813(*l*)(1). In addition, the arguments of the FDIC and its *amici* on this point are unsupported (and contradicted) by the regulatory and legislative history of the statute.

Affirming the holdings of the court of appeals and the district court would not violate, but rather would promote, the purpose of the Federal Deposit Insurance Act. The Act is not as narrow as the FDIC suggests, as it affords the benefits of federal deposit insurance to many persons who do not entrust funds to a bank. The Act was intended by Congress to extend the benefits of deposit insurance to a class of persons dealing with banks who had not theretofore been recognized as "depositors" in the traditional sense. Within the parameters laid out in the

statute by Congress, certain of these creditors of banks are afforded the benefits of federal deposit insurance. Congress, and the FDIC, did not intend that these persons should be denied the benefits of deposit insurance because of a former technical distinction between a depositor and a creditor.

Even if Section 1813(*l*)(1) were ambiguous, the FDIC's lately proffered administrative interpretation is entitled to no deference, because it falls far short of the standards that would entitle it to such deference. Its reasoning is faulty, as it would impose too limited a scope on the Act and would render nugatory the reference to a promissory note in the statute's proviso. Moreover, the FDIC has not thoroughly considered the interpretation it has announced before the Court, and that interpretation is inconsistent with its earlier pronouncements, in this litigation and elsewhere. The Court is the final authority on issues of statutory construction and should reject the FDIC's interpretation, as it is contrary to the language of the statute.

The conjecture of the FDIC and the *amici* who seek reversal about the impact of affirmance on the tax-exempt status of certain municipal and industrial revenue bond issues should not deter the Court from applying the clearly expressed intent of Congress to the facts of this case. There is no indication in the legislative history of the Deficit Reduction Act of 1984 that Congress intended municipal and industrial revenue bond issues backed by standby letters of credit to lose their tax-exempt status, nor is there any indication that Congress assumed that such standby letters of credit were not insured deposits. Moreover, under the plain terms of the statute, any question about the tax-exempt status of bonds backed by such standby letters of credit can be eliminated simply, if promissory notes are not received by the issuing banks in exchange for the letters of credit.

Because the arguments by the FDIC and *amici* that affirmance would somehow disrupt the banking industry or the market in tax-free municipal bonds are not supported by the record, they are extremely difficult for the Court to evaluate. These arguments deal more with the wisdom of the statute than its intent, and so should be directed to its drafters. The Court, as it consistently has held, construes but does not rewrite legislation. Section 1813(*l*)(1) is clear, and fits the facts of this case squarely.

ARGUMENT

THE LETTER OF CREDIT ISSUED TO RESPONDENT IS A DEPOSIT UNDER 12 U.S.C. § 1813(*l*)(1)

A standby letter of credit such as was issued by Penn Square Bank to respondent in this case typically is payable upon presentation by the beneficiary of a draft, certain documents (specified in the letter), and a certification by the beneficiary that the account party has not paid the beneficiary on their underlying contract. J. Dolan, The Law of Letters of Credit ¶¶1.04, 1.05 (1984). The issuing bank is primarily liable on its standby letter of credit.[4]

4. The court of appeals' holding that Penn Square Bank was primarily liable on respondent's letter of credit within the meaning of Section 1813(*l*)(1) is not challenged by the FDIC (Brief for Petitioner at 7 n.7), the American Bankers Association, the California Bankers Clearing House Association, and the New York Clearing House Association (collectively, "ABA"), or the *amici* that are not banking associations. Only the Council on International Banking, Inc. ("CIB") challenges that holding, the correctness of which is established by the numerous cases where the issue has been addressed. *See, e.g., KMW International v. Chase Manhattan Bank*, 606 F.2d 10, 15-16 (2d Cir. 1979); *East Girard Savings Ass'n v. Citizens National Bank & Trust Co.*, 593 F.2d 598, 601-02 (5th Cir. 1979); *Bank of North Carolina, N.A. v. Rock Island Bank*, 570 F.2d 202, 206 n.7 (7th Cir. 1978); *Chase Manhattan Bank, N.A. v. Equibank*, 550 F.2d 882, 885, 886 (3d Cir. 1977); *Fidelity Bank v. Lutheran Mutual Life Insurance Co.*, 465 F.2d 211, 213 (10th Cir. 1972). *See* Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716, 736 (1973), citing U.C.C. § 3-410(1); Comment, *Recent Extensions in the Use of Commercial Letters of Credit*, 66 Yale L.J. 902, 904 n.10 (1957).

Letters of credit, along with the other credit instruments of banks listed in Section 1813(*l*)(1) (including certificates of deposit, thrift certificates, investment certificates and certificates of indebtedness), can, under the circumstances outlined in the statute, be insured deposits of member banks. Section 1813(*l*)(1) provides for the status of letters of credit as deposits (which, under Section 1813(m), will be insured) as follows:

> (*l*) The term "deposit" means —
>
> (1) The unpaid balance of money or its equivalent received or held by a bank in the usual course of business . . . which is evidenced by . . . a letter of credit . . . on which the bank is primarily liable:[5] *Provided:* That, without limiting the

The FDIC's recognition of the nearly absolute liability of banks on standby letters of credit is codified in its interpretive regulation requiring banks to include the amounts of such letters within their legal lending limits and to disclose the amounts in their financial statements. 12 C.F.R. § 337.2; *see* U.C.C. § 5-114(1).

5. The regulatory history of Section 1813 (*l*)(1) provides solid support for a conclusion that the limiting phrase "primarily liable" is meant to modify only "traveler's check," not "letter of credit." Regulation I formerly referred to "[o]utstanding traveler's checks or letters of credit on which the bank is primarily liable." 12 C.F.R. § 301.1(c) (1939), quoted in *Federal Deposit Ins. Corp. v. Irving Trust Co.*, 137 F. Supp. 145, 148 (S.D.N.Y. 1955). In 1955, however, the FDIC reversed the order to read as follows: "[o]utstanding letters of credit or traveler's checks on which the bank is primarily liable." 12 C.F.R. § 326.1(c) (1955). This changed language was incorporated into Section 1813(*l*)(1).

In a footnote to the 1955 regulation, the FDIC explained the reversal of the order of the words as follows:

> The change in the wording of this paragraph is a clarification of the consistent interpretation by the Corporation of the term "letters of credit" to include *all letters of credit* issued under the circumstances stated in this paragraph.

12 C.F.R. § 326.1(c) n.2 (1955) (emphasis added). It seems clear, therefore, that the limiting phrase "primarily liable" was not intended by the FDIC to apply to letters of credit, and nothing in the legislative history of the 1960 amendments to the Federal Deposit Insurance Act indicates that Congress intended the phrase to apply to letters of credit.

> generality of the term "money or its equivalent," any such . . . instrument must be regarded as evidencing the receipt of the equivalent of money when . . . issued in exchange for . . . a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable. . . .

These words are plain. They squarely fit the facts of the instant case, and establish that the district court and the court of appeals correctly decided the issue before them. It is easy to see the rationale of Congress in Section 1813(*l*)(1) when it is recognized that when a bank receives a promissory note and issues in exchange therefor a letter of credit, the bank has received an asset and incurred a corresponding liability:

> [T]he establishment of a letter of credit is precisely identical with a deposit and loan transaction in the sense that the bank is creating both a liability and an asset.
>
> In the classic situation, the bank first creates a liability by receiving money on deposit and thus incurring a liability to its depositor. It then creates an earning asset by lending that or an equivalent amount of money to its borrower. In the case of the letter of credit, the sequence is reversed, but the transaction is identical. The bank creates an asset in the form of its customer's promise to pay to the bank an amount of money equivalent to the amount of money that the bank will pay under the letter of credit. As an offset to that asset, the bank undertakes a corresponding liability to the beneficiary of the letter of credit.

Harfield, *The Standby Letter of Credit Debate*, 94 Banking L. J. 293, 298 (1977).

This analysis of the typical letter of credit transaction provides some insight into the purpose behind the inclusion of a promissory note in the proviso of Section 1813 (*l*)(1). The proviso evidences an understanding by Congress of the similarity of the letter of credit transaction to the classic deposit and loan transaction. The bank's asset — the account party's obligation to repay it for all advances to the beneficiary under the letter of credit — is offset by the bank's credit liability to the beneficiary of the letter of credit. When the account party and the issuing bank have formalized and elevated the reimbursement obligation so that it takes the form of a promissory note, the bank, under the statutory scheme, is deemed to have received the equivalent of money. As a consequence, the credit instrument the bank has issued — its letter of credit — is recognized by the statute as an insured deposit. Put another way, when the account party's obligation to repay the issuing bank becomes "money or its equivalent" (defined in the statute as a promissory note on which the account party is primarily or secondarily liable), then the credit liability of the bank to the beneficiary of the letter of credit becomes a deposit liability, and is insured.

This construction of the statute is reasonable, promotes the purpose of the federal deposit insurance system, and is in accord with the plain terms of the statute. Nothing in Section 1813(*l*)(1) or in its legislative history indicates that Congress intended anything other than what these words in their common, ordinary meaning suggest. *Richards v. United States*, 369 U.S. 1, 9 (1962) ("[W]e must, of course, start with the assumption that the legislative purpose is expressed by the ordinary meaning of the words used.").

I. Respondent's Letter of Credit Was Issued in Exchange for "Money or its Equivalent."

Section 1813(*l*)(1) commands that a letter of credit "*must be regarded* as evidencing the receipt of the equivalent of money" when issued in exchange for a promissory note upon which the account party is primarily or secondarily liable. (Emphasis added.) Clearly, Orion's note (J.A. 27-30) is just such a promissory note. As the court of appeals correctly noted, the note contains on its face no qualification to the unconditional promise to pay the sum of money specified therein. See U.C.C. §§ 3-104, 3-105(1)(a) (unconditional promise to pay contained in note is not made conditional by fact that note is subject to implied or constructive conditions) and Official Comment. The statute plainly directs that respondent's letter of credit, issued by Penn Square Bank in exchange for Orion's promissory note, is an insured deposit. See *Caminetti v. United States*, 242 U.S. 470, 485 (1917).

The FDIC and those *amici* who seek reversal of the decision below try to escape the plain words of Section 1813(*l*)(1) by reading into the language a condition neither expressed nor fairly implied, and one which finds no support in the legislative or regulatory history of the statute. Reduced to essentials, their argument is that Orion's promissory note could only be considered the equivalent of money if Penn Square Bank had "funded" the letter of credit by giving credit in the amount of the note to Orion's account or to another, special account from which respondent's drafts on the letter of credit would be paid. Only in this way, the FDIC and *amici* argue, could there be an entrustment of funds entitled to the protection of the deposit insurance system.[6]

6. Brief for Petitioner at 17-22; ABA Brief at 12 *et seq.*; CIB Brief at 9-11. One *amicus* goes so far as even to suggest that Orion's promissory note was nothing more than a memorialization of the statutory obligation of the account party to reimburse the issuing bank for drafts paid, see U.C.C. § 5-114(3), and conferred on Penn Square Bank no rights beyond those it already had by operation of law. CIB Brief at 5-6, 12. This argument ignores what is apparent from the record. Clearly, a promissory note gives an issuing bank far greater and more specific rights relating to the payment of principal and interest, remedies upon default, and other matters, than does the mere statutory obligation to reimburse. Compare Orion's promissory note (J.A. 27-30) with U.C.C. § 5-114(3).

The wrongness of this argument is apparent from a simple reading of the statutory language, which is "[t]he starting point in every case involving construction of a statute," *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring). If the issuing bank structures the letter of credit transaction so that the customer's account or another, special account is credited with actual funds in the amount of the promissory note, the letter of credit is issued in exchange for "money . . . held by a bank," and fits Section 1813(*l*)(1)'s definition of "deposit" without reference to the promissory note language in the proviso. Treating the funds as security would still not bring the proviso into play, as the letter of credit then would qualify as a deposit under Section 1813(*l*)(3),[7] dealing with "special purpose" funds.

The weakness of the argument is further highlighted by an FDIC regulation promulgated shortly after the decision in *Irving Trust Co., supra*, 137 F. Supp. 145. In that regulation, Assessment Decision No. 109, 12 C.F.R. § 327.209 (1956), the FDIC, in subsection (b), expressly distinguished reimbursement agreements from promissory notes, ruling that a letter of credit issued against a promissory note would be subject to assessment (as an insured deposit), while a letter of credit issued against only a reimbursement agreement would not. See pp. 31-32, *infra*.

7. The term "deposit" means —

> (3) money received or held by a bank, or the credit given for money or its equivalent received or held by a bank . . . for a special or specific purpose. . . including without being limited to . . . funds held to meet its . . . letters of credit. . . .

12 U.S.C. § 1813(*l*)(3).

The FDIC relies upon the decision in *Irving Trust Co., supra*, 137 F. Supp. 145, as support for its argument that Section 1813(*l*)(1) requires that a letter of credit be "funded" to be an insured deposit. Brief

The FDIC's and *amici's* argument completely reads out of Section 1813(*l*)(1) the proviso's reference to promissory notes. Only by construing the proviso to include "unfunded" (as that term is used by the FDIC and *amici*) letters of credit issued in exchange for promissory notes can the Court give effect to the entirety of the statute. Congress in Section 1813(*l*)(1) required only that a letter of credit be issued in exchange for a promissory note, without reference to whether it is "funded" or "unfunded".[8]

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for Petitioner at 15, 22. That decision, however, was directed only toward accounts that are now treated by Section 1813(*l*)(3), which is not at issue in this case. In 1960, the FDIC's general counsel acknowledged this in a letter that was among data provided by the FDIC to Congress in legislative hearings on the 1960 amendments to the Act. *Hearings Before the Subcommittee of the House Committee on Banking and Currency on H.R. 8916 and H.R. 8928*, 86th Cong., 2d Sess. 112 (1960) (letter by Royal Coburn) ("In this case. . .fourteen types of collateral and other special purpose funds were in issue, and the Court held that each one of them constituted a 'deposit' under the Federal deposit insurance law. . . .").

Before the district court in this case, the FDIC acknowledged that the issue in *Irving Trust Co.* "was whether the letters of credit themselves were deposits under FDIC Regulation I(c) — for all practical purposes the contemporary equivalent of Section 1813(*l*)(3)." Brief of Federal Deposit Insurance Corporation, In Its Corporate Capacity, In Reply to Plaintiff's Response to Motion for Summary Judgment at 17 (July 7, 1983) (R. 221). The court in *Irving Trust Co.*, therefore, did not address letters of credit issued in exchange for promissory notes, and its decision provides no support for the FDIC's present claim that Section 1813(*l*)(1) commands the entrustment of funds.

8. It is not logical for the FDIC and *amici* to argue that the federal deposit insurance system was designed to protect only those who entrust their funds to a bank. Brief for Petitioner at 12-15, ABA Brief at 13, CIB Brief at 10, but to concede that a "funded" letter of credit issued in exchange for a promissory note is insured, while an "unfunded" letter is not. An account party who exchanges his note for a letter of credit that is "funded" by the bank (only in the sense that some account is credited) has not entrusted his own funds any more than the account party who exchanges his note for a letter of credit the bank elects not to "fund." This inconsistency in the FDIC's position is another factor weighing against its claim that its interpretation of the statute is entitled to deference. See pp. 20-32, *infra*.

Moreover, the argument that the deposit insurance system protects only those who entrust funds to a bank ignores the fact that the Act, on its face, is not so limited. The Act expressly provides deposit insurance coverage to many creditors of banks who have not entrusted any funds:

> The term "deposit" means –
>
> (4) outstanding draft (including advice or authorization to charge bank's balance in another bank), cashier's check, money order, or other officer's check issued in the usual course of business *for any purpose*, including without being limited to those issued in payment for services, dividends, or purchases. . . .

12 U.S.C. § 1813(*l*)(4) (emphasis added). Ordinary creditors of a bank who hold the instruments described in Section 1813(*l*)(4) have not entrusted funds or anything of value to the bank for safekeeping, but nevertheless are insured depositors. The protection of the deposit insurance system is not so narrow as the FDIC and *amici* suggest.[9]

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9. The FDIC and *amici* rely heavily upon an isolated passage in a document entitled *Transcript of Notes Taken at Special Meeting of N.Y. Bank Comptrollers and Auditors Conference* (Sept. 27-28, 1935) [hereinafter cited as 1935 Transcript], which is a transcript of an informal meeting between FDIC officials and certain New York bank officers following passage of the Banking Act of 1935. The meeting opened with an address by FDIC officials explaining the broad meaning of the term "total deposits," 1935 Transcript at 1-4, continued with a detailed discussion of the method of filling out the forms generated by the FDIC for calculating assessments, *id.* at 4-13, and concluded with a question-and-answer session, *id.* at 14 *et seq.*

The passage quoted by the FDIC and *amici* (Brief for Petitioner at 24, ABA Brief at 6, CIB Brief at 14), in support of their view that only "funded" letters of credit are insured deposits, was a response to a question directed toward letters of credit issued by a charge against a customer's account. 1935 Transcript at 25-26. The court in *Irving Trust*

The FDIC further attempts to support its unwarranted distinction between "funded" and "unfunded" letters of credit by arguing that the other instruments listed in the proviso of Section 1813(*l*)(1) are inherently more valuable than a promissory note, justifying a more restrictive meaning of the term "promissory note" than the language of the statute suggests.[10] A similar argument made by the Federal Reserve Board in *Securities Industry Ass'n v. Board of Governors of the Federal Reserve System*, 104 S. Ct. 2979 (1984), was rejected by the Court. There, the Court faced the question whether a provision of the Glass-Steagall Act, codified at 12 U.S.C. § 378(a)(1), which prohibits member banks of the Federal Reserve System from marketing, *inter alia*, "notes or other securities," prohibited a member bank from selling third party commercial paper. The Federal Reserve Board argued that the context in which the admittedly unambiguous term "notes" was used in the Act suggested that a narrower definition was warranted, and justified the distinction (unexpressed in the statute) the Board drew between notes resembling investments and those resembling loans. 104 S. Ct. at 2986-87.

Co., supra, cautioned that "the answers in the transcript appear at best to be of only slight value," 137 F. Supp. at 161, not least because "[a]t the meeting the FDIC officials made it clear they were not attempting to law down final definitive rulings." *Id.*

10. Brief for Petitioner at 18. This argument, in addition to its other failings — that it ignores the ordinary meaning of the term "promissory note," *cf. Richards v. United States*, 369 U.S. 1, 9 (1962), and treats the reference to promissory notes as mere surplusage, *cf. Bowsher v. Merck & Co.*, 460 U.S. 824, 833 (1983) — finds no support in either the legislative or regulatory history of the statute. See pp. 23-29, *infra*.

The Court, in language equally applicable to the distinction the FDIC now attempts to draw between "funded" and "unfunded" letters of credit, stated:

> The difficulty with the Board's attempt to narrow the ordinary meaning of the statutory language is evidenced by the Board's unsuccessful efforts to articulate a meaningful distinction between notes that the Act purportedly covers and those it does not. . . .
>
> Without some clearer directive from Congress that it intended the statutory terms to involve the nebulous inquiry described by the Board, we cannot endorse the Board's departure from the literal meaning of the Act. The Court, in another context, has said pertinently:
>
> > "Had Congress intended so fundamental a distinction, it would have expressed that intent clearly in the statutory language or the legislative history. It did not do so, however, and it is not this Court's function 'to sit as a superlegislature.' . . . and create statutory distinctions where none were intended."

104 S. Ct. at 2988, quoting *American Tobacco Co. v. Patterson*, 456 U.S. 63, 72 n. 6 (1982) and *Griswold v. Connecticut*, 381 U.S. 479, 482 (1985). Here, as in *Securities Industry Ass'n*, the distinction the FDIC asks the Court to draw is so fundamental that it would surely have been expressed in the statute if it were warranted.

Congress clearly decided that when a bank issuing a letter of credit requires of the account party a promissory note — which gives the bank specific rights dealing with

interest, repayment of principal, and accessory obligations (see Orion's promissory note, J.A. 27-30) far greater in scope than the mere statutory obligation of the account party under U.C.C. § 5-114(3) to reimburse the bank for amounts paid — then, in those circumstances, the beneficiary of the letter of credit is an insured depositor. The representatives of the FDIC who participated in the meeting with New York bank comptrollers and auditors from which the 1935 Transcript was drawn made clear in their introductory remarks that the term "deposit" was to be construed broadly, [11] and that Congress intended to allow certain creditors of the bank (those who had claims evidenced by the bank's credit instruments) in certain circumstances to be afforded the status of depositors and "not be deprived of insurance protection because of any legalistic distinction between a depositor and a creditor." 1935 Transcript at 2. The representatives at that meeting explained as follows:

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11. 1935 Transcript at 1. Although the answers by the FDIC officials to the bank officers' questions in the 1935 Transcript do not themselves merit heavy reliance, see note 9, *supra*, one of the explanations by a member of the FDIC's Legal Division does suggest an analogy that is apropos here:

> A man who is not a depositor comes in and borrows half a million dollars and is given a cashier's check in that amount. The cashier's check was issued for money or its equivalent. That is the same situation as if you loaned me half a million dollars and set up an ordinary account against which I would draw.

Id. at 15-16 (remarks of J. E. Markham, FDIC Legal Division). In this example, since half a million dollars were borrowed, it is assumed that a promissory note was executed. Because a cashier's check issued in exchange for that promissory note "was issued for money or its equivalent," so must be a letter of credit, as both a cashier's check and a letter of credit are among the credit instruments listed in Section 1813 (*l*)(1) as insured deposits in that circumstance.

> Consequently, the law contemplated extending the benefits of insurance to those persons who, under certain circumstances, accepted credit instruments of the bank, by treating such persons as depositors and such obligations as deposit obligations.
>
> . . . .
>
> Your attention is directed to Regulation I which provides in part that credit instruments issued for money or "its equivalent" are deposit obligations of the bank. The question immediately arises as to the meaning of the words "its equivalent." The Corporation has defined "its equivalent" as meaning "checks or drafts or promissory notes upon which the person procuring any of the enumerated instruments is primarily or secondarily liable."

Id. (remarks of J.E. Markham, FDIC Legal Division).

Section 1813 (*l*)(1), clearly, is not limited to "funds," or to "money," but affords the protection of federal deposit insurance to letters of credit issued in exchange for "money or its equivalent," unambiguously defined in the statute as including promissory notes. The FDIC's and *amici's* reading of the statute reads out of the proviso its reference to promissory notes, and violates the important principle of statutory construction that every term in a statute should, if possible, be given meaning. *Bowsker v. Merck & Co.*, 460 U.S. 824, 833 (1983); *American Textile Manufacturers Institute, Inc., v. Donovan*, 452 U.S. 490, 513 (1981). As the court in *Irving Trust Co.* recognized, "[t]he Court may not rewrite the statute by substituting the defendants' definition of 'deposit' for the one which Congress enacted." 137 F. Supp. at 155.

II. The Interpretation of Section 1813 (*l*)(1) Advanced by the FDIC at This Stage of the Proceedings Is Not Entitled to Deference.

The FDIC argues that the Court should defer to its interpretation of 12 U.S.C. § 1813(*l*)(1), based upon its fifty-year history of administering the deposit insurance program and what it reads as indications by Congress[12] that its views should be "accorded great deference." Petitioner's Brief at 22; *id.* at 22-27. Those *amici* who seek reversal of the decision below join in this argument. ABA Brief at 5-9; CIB Brief at 13-15.

The principle cited by the FDIC is one developed by the Court for the elucidation of ambiguous statutes. The Court has made clear, however, that if the statute is not ambiguous, the need to defer to an agency's construction simply does not arise:

> It is elementary that the meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain, and if the law is within the constitutional authority of the lawmaking body which passed it, the sole function of the courts is to enforce it according to its terms. . . .
>
> Where the language is plain and admits of no more than one meaning, the duty of interpretation does not arise, and the rules which are to aid doubtful meanings need no discussion.

Caminetti v. United States, 242 U.S. 470, 485 (1917).

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12. 12 U.S.C. § 1813(*l*)(5) and § 1819 Tenth. See pp. 22-23, *supra*.

> First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress. . . .
>
> The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent.

Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 104 S. Ct. 2778, 2781-82 & n.9 (1984), citing *Federal Election Comm'n v. Democratic Senatorial Campaign Committee*, 454 U.S. 27, 32 (1981); *Securities and Exchange Comm'n v. Sloan*, 436 U.S. 103, 117-18 (1978); see *American Tobacco Co. v. Patterson*, 456, U.S. 63, 72 n.6 (1982); *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975)(Powell, J., concurring). As this Court long ago said, "[i]t is emphatically the province and duty of the judicial department to say what the law is." *Marbury v. Madison*, 1 Cranch 137, 177, 2 L. Ed. 60, 73 (1803).

Section 1813(*l*)(1) is not ambiguous. Its plain terms control this case. Even if the statute were ambiguous, however, and the Court were to determine that it should examine the FDIC's interpretation of the statute as an aid to its construction, the deference merited by the FDIC's view depends upon the familiar standards enunciated by the Court in *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944):

> The weight of such a judgment in a particular case will depend upon the thoroughness evident in its consideration, the validity of its reasoning,

> its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control.

Id. at 140, cited in *Adamo Wrecking Co. v. United States*, 434 U.S. 275, 287 n.5 (1978).

Measured against these standards, the construction proffered by the FDIC at this stage of the case is entitled to no deference. The FDIC's construction does not show thorough consideration and valid reasoning; rather, it is no more than an admitted departure in practice from the clear terms of the statute and the FDIC's regulations on the issue. In addition, its present interpretation is at odds with its earlier pronouncements on the issue, both in this litigation and elsewhere.

A. The FDIC Has Not Thoroughly Considered the Issue, and Its Reasoning Is Not Valid.

The FDIC's now-announced interpretation of Section 1813(*l*)(1) — that it does not include "unfunded" standby letters of credit issued in exchange for promissory notes — is an attempt to narrow the definition of a deposit from that expressed in the statute. While Section 1813(*l*)(5) grants to the FDIC authority to *expand* the definition of "deposit" to include instruments or accounts not otherwise identified in other subsections of Section 1813(*l*), it has no authority anywhere in the statute to narrow the statutory definition, least of all under Section 1819 Tenth, which simply gives it rulemaking authority to carry out the congressionally expressed intent. This is not a case where "Congress has explicitly left a gap for the agency to fill." *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 104 S. Ct. 2778, 2782 (1984), as Congress in Section 1813(*l*)(5) expressly empowered the FDIC only to expand,

not to narrow, the statutory definition of "deposit." Since Congress specifically focused upon the FDIC's authority on this issue in Section 1813(*l*)(5), it clearly would have granted the FDIC the power to narrow the statutory definition if it wished. *Cf. Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 109 (1980).

In addition, the legislative histories of the congressional acts addressing federal deposit insurance — the Banking Act of 1935, ch. 614, 49 Stat. 684; the Federal Deposit Insurance Act of 1950, ch. 967, 64 Stat. 873; and the present statute, 12 U.S.C. § 1811 *et seq.* — show that in all the times the FDIC discussed the deposit insurance program in committee and subcommittee hearings, it did not once draw the distinction it now asks the Court to draw between "funded" and "unfunded" letters of credit. The Senate hearings on the 1935 Act contain no mention of the statutory definition of the term "deposit" by the chairman of the board of the FDIC or its general counsel. See *Hearings Before the Subcommittee of the Senate Committee on Banking and Currency on S. 1715 and H.R. 7617*, 74th Cong., 1st Sess. 24-50, 51-61, 181-87 (statements of Leo T. Crowley); *id.* at 174-77 (statement of L. E. Birdzell). In the House hearings on the 1935 Act, similarly, the only reference to the definition of "deposit" was a recitation of the statutory language by the FDIC's general counsel, and the only particular application of that definition discussed by him related to the provisional credit given by banks for items presented for collection. See *Hearings Before the House Committee on Banking and Currency on H.R. 5357*, 74th Cong., 1st Sess. 54-55 (1935) (statement of L. E. Birdzell). None of the other testimony before the House committee by the FDIC's general counsel and its chairman related to the statutory definition of the term. *Id.* at 1-27, 29-50, 51-82, 83-111, 113-42. The committee report on the 1935 Act, likewise, does not address the definition of the

term "deposit." H.R. Rep. No. 752, 74th Cong., 1st Sess. (1935).

The 1935 Act was amended by Congress in 1950. The amendments increased insurance coverage from $5,000 to $10,000, simplified the computation of the assessment base, reduced banks' deposit insurance premiums in years when the FDIC did not suffer undue losses, expanded the FDIC's examination authority, and provided for the repayment to the Treasury of the capital funds originally provided for the deposit insurance program. H.R. Rep. No. 2564, 81st Cong., 2d Sess. 5 (1950). The House committee report shows that the 1950 Act's redefinition of the term "insured deposit" related only to the increase in insurance coverage, parity between state and federal deposits, and a definition of the term "trust funds." *Id.* at 6. Nowhere in the House committee report is there any indication of a distinction drawn by the FDIC between "funded" and "unfunded" letters of credit for deposit insurance purposes, nor any indication that the committee even considered the question of the status of letters of credit as insured deposits. The Senate committee report on the 1950 legislation likewise shows no such distinction drawn by the FDIC. S. Rep. No. 1269, 81st Cong., 2d Sess. 1-4 (1950).

None of the FDIC officials who testified at the hearings in the House and Senate on the 1950 Act made any reference to a differentiation between "funded" and "unfunded" letters of credit. See *Hearings Before the House Committee on Banking and Currency on S. 2822*, 81st Cong., 2d Sess. 17-42 (1950) (statements of Maple T. Harl, E. H. Cook, and Russell Miller); *id.* at 18-22 (statement of L. E. Birdzell); *Hearings Before the Subcommittee of the Senate Committee on Banking and Currency on S. 80, S. 2094, S. 2300, S. 2307 and S. 2822*, 81st Cong., 2d Sess. 18-43, 144-50 (1950) (statements of Maple T. Harl and Leo Crowley).

The 1960 amendments to the Federal Deposit Insurance Act had as their principal purpose the simplification of the assessment procedure. These amendments eliminated the need for banks to keep assessment records separate from their reports of condition, by basing the deposit insurance premium assessments on the information contained in the reports of condition. See H.R. Rep. No. 1827, 86th Cong., 2d Sess. 3 (1960). The section-by-section summary of the amendments to the Act in the House report stated only, with regard to the definition of "deposit," that Section 3(*l*) of the Act (12 U.S.C. § 1813(*l*)) would include the statutory definition of deposits "and the definition of deposits in the rules and regulations of the Federal Deposit Insurance Corporation," with certain other changes not dealing with letters of credit. *Id.* at 5. Identical language appears in the Senate report, S. Rep. No. 1821, 86th Cong., 2d Sess. 10 (1960), *reprinted in* 1960 *U.S. Code Cong. & Ad. News* 3234, 3243.

The hearings on the 1960 amendments also show that the FDIC there again failed to draw the distinction between "funded" and "unfunded" letters of credit it now asks the Court to draw in this case. In the House hearings, the FDIC chairman acknowledged the limited principal purpose of the bill "to simplify the computation and reporting of assessments payable by insured banks to the Corporation." *"Hearings Before the Subcommittee of the House Committee on Banking and Currency on H.R. 8916 and H.R. 8928*, 86th Cong., 2d Sess. 9 (1960) (statement of Jesse P. Wolcott), and his only elaboration of the definition of the term "deposit" related to the difference between the definition in the call reports and in the FDIC's regulations. *Id.* at 12. The FDIC controller's sole reference to the present statutory definition of the term substantially tracked the language of the statute:

> Under the proposed amendments, letters of credit and traveler's checks issued for money or its equivalent would be included in deposits in the report of condition and the assessment base and will be insured. . . . [L]etters of credit and traveler's checks issued for money or its equivalent should be reported as deposit liabilities.

Id. at 21-22 (statement of William G. Loeffler). None of the questions of the FDIC officials by the subcommittee members related to the statutory definition of the term "deposit." *Id.* at 29-33, 46-63, 102-08. In the Senate hearings, the portion of the supplementary statement of Mr. Loeffler that dealt with the statutory definition of the term "deposit" was identical to his above-quoted statement in the House hearing.[13] *Hearings Before the Senate Committee on Banking and Currency on H.R. 12465*, 86th Cong., 2d Sess. 50 (1960) (supplementary statement of William G. Loeffler).

In sum, nowhere in the legislative histories of the Acts affecting the federal deposit insurance system in 1935, 1950 or 1960 does there appear any support for the FDIC's newly announced interpretation of the statute. In fact, in its first regulation on the issue, Regulation I, the FDIC explained when letters of credit would be considered as being issued in exchange for "money or its equivalent" in this way:

> [L]etters of credit must be regarded as issued for the equivalent of money when issued in exchange

13. This is the statement cited by the FDIC in support of its argument that "the FDIC's general regulatory approach was called to the attention of Congress at that time. . . ." Brief for Petitioner at 25.

> for checks or drafts or for promissory notes upon which the person procuring any of the enumerated instruments is primarily or secondarily liable.

12 C.F.R. § 301.1(d) (1939), quoted in *Irving Trust Co., supra*, 137 F. Supp. at 148. And in the 1935 Transcript, the FDIC representative announced the FDIC's definition of the term "money or its equivalent," stating that "[t]he Corporation has defined 'its equivalent' as meaning 'checks or drafts or promissory notes upon which the person procuring any of the enumerated instruments is primarily or secondarily liable.' " 1935 Transcript at 2, drawing no distinction between "funded" and "unfunded" letters of credit.

How can the FDIC now claim that "Congress affirmatively intended to endorse the FDIC's treatment of unfunded standby letters of credit," and that it has been " 'fully brought to the attention of the public and the Congress,' " Brief for Petitioner at 26, quoting *United States v. Rutherford*, 442 U.S. 544, 554 n.10 (1979), when its interpretation has never before been mentioned in the legislative or regulatory history of the statute? In *Securities and Exchange Comm'n v. Sloan*, 436 U.S. 103 (1978), the Court, in a case where the legislative history more strongly supported the agency's interpretation of the statute than here, rejected a similar claim by the SEC. There the SEC had issued a series of consecutive ten-day orders suspending trading in the common stock of a corporation for over a year. As does the FDIC in this case, the SEC claimed that its construction of the statute was entitled to deference, as it had administered the statute and made its views known to Congress. The Court, noting the tenuous basis in the legislative history for the SEC's statutory construction, rejected its claim that its interpretation was

entitled to deference:

> Here the administrators, so far as we are advised, made no reference at all to their present construction of Section 12(k) to the Congress which drafted the "enabling legislation" here in question – the Securities Exchange Act of 1934. They made known to at least one committee their subsequent construction of that section 29 years later, at a time when the attention of the Committee and of the Congress was focused on issues not directly related to the one presently before the court. . . .
>
> We are extremely hesitant to presume general congressional awareness of the Commission's construction based only upon a few isolated statements in the thousands of pages of legislative documents. That language in a Committee Report, without additional indication of more widespread congressional awareness, is simply not sufficient to invoke the presumption in a case such as this.

Id. at 120-21. Where the legislative history supporting the agency's statutory interpretation in *Sloan* was weak, here it is nonexistent.

This point is highlighted by the failure of the FDIC to mention a distinction between "funded" and "unfunded" letters of credit either in the regulations it has issued to clarify and define insurance coverage of deposits, 12 C.F.R. Part 330 ("Clarification and Definition of Deposit Insurance Coverage"); or in those it has issued dealing with assessments, *id.* Part 327. The FDIC has, however, distinguished "funded" and "unfunded" letters of credit in other regulations, those dealing with lending limits, 12

C.F.R. § 337.2, and financial statement disclosure, *id.* § 335.621(g). Plainly, the FDIC considered the distinction important in these contexts, but not, at least until this litigation, in the context of deposit insurance.[14] The FDIC has shown no well-considered and validly reasoned analysis, only a departure in practice from what the statute requires.

B. The FDIC's Interpretation of the Statute Is Inconsistent With Its Earlier Pronouncements.

In its Brief, the FDIC maintains that it has "informally but consistently" excluded "unfunded standby letters of credit from the definition of deposit, from the moment of the regulation's promulgation. . . ." Brief for Petitioner at 24. Its position before the Court is at odds with its earlier affirmative statements on the issue, both in this litigation and in its past regulations. Before the district court, the FDIC made no claim of any longstanding administrative interpretation; before the court of appeals, it maintained that it has consistently excluded *all* standby letters of credit from deposit insurance coverage, not merely "unfunded" standby letters as it now claims. See Brief of Federal Deposit Insurance Corporation in Its Corporate Capacity before the Tenth Circuit Court of Appeals, at 6 (Aug. 31, 1984) ("The FDIC has consistently interpreted 12 U.S.C. § 1813 (and its predecessors) to exclude standby letters of credit from the definition of a deposit. . . .").[15]

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14. Indeed, the FDIC acknowledges that it has not heretofore drawn the distinction it now asks the Court to draw between "funded" and "unfunded" letters of credit. FDIC Reply Brief in support of Petition for *Certiorari*, at 4 n.3 ("the FDIC in the past has treated as uninsured *all* $120 billion worth of outstanding standby letters of credit") (emphasis added).

15. The FDIC's several estimates of the amounts of letters of credit that supposedly would be affected by affirmance have also varied dramatically. In its Petition for a Writ of *Certiorari*, at 19, and in its

The FDIC's shift from the positions it took before the district court and the court of appeals strongly counsels against deferring to its most recent interpretation of the statute. In the *Securities Industry Ass'n* case,*supra*, 104 S. Ct. at 2983-84, the Court, noting that the Federal Reserve Board had adopted a different position before the Court on the interpretation of a statute than it had during administrative hearings, declined to defer to its interpretation:

> [T]he Board's presentation here of the policies behind the Act as they apply to this case is of less significance than it would be if it had occurred at the administrative level. Because of this apparent shift, moreover, the contours of the Board's present position are somewhat unclear. . . . To the extent that the Board has changed its position from that adopted at the administrative level, its interpretation is entitled to less weight.

Id.; *cf. Federal Maritime Comm'n v. Seatrain Lines, Inc.* 411 U.S. 726, 745 (1973). Here, before this litigation, the FDIC had no announced position on the question presented which was at odds with the clear terms of the statute; after

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Reply Brief in support of the Petition, at 4 n.3, the FDIC estimated that $120 billion in standby letters of credit are now outstanding; in its Brief on the merits, at 27, the FDIC now says that this is the amount of outstanding *unfunded* standby letters of credit. Before the Tenth Circuit Court of Appeals, the FDIC suggested that the amount of all standby letters of credit was "$450,000,000,000 to $500,000,000,000 . . . during the last five years." Petition of Federal Deposit Insurance Corporation in Its Corporate Capacity for Rehearing In Banc at 2 (January 10, 1985).

Because there is no support in the record for these statements, it is difficult to determine which, if any, is accurate. The acknowledgment by the FDIC that it does not maintain records of the number of standby letters of credit backed by promissory notes (FDIC Reply Brief in support of its Petition for *Certiorari*, at 4 n.3) indicates that no realistic estimate can be made of the amount of letter of credit transactions fitting the fact pattern of this case.

this litigation commenced, the FDIC's position has been only shifting and confused.

Two interpretations issued by the FDIC after the passage of the Federal Deposit Insurance Act of 1950, ch. 967, 64 Stat. 873 *et seq.*, point up the inconsistency of the FDIC's presently announced position with its earlier statements on the issue. In its amendment of Regulation I following passage of the 1950 Act, the FDIC, more than merely failing to make a distinction between "funded" and "unfunded" letters of credit, stated affirmatively that it had been its "consistent interpretation . . . of the term 'letters of credit' to include *all letters of credit*" issued for money or its equivalent or for a charge against a deposit account. 12 C.F.R. § 326.1(c) n.2 (1955) (emphasis added).

Another interpretation promulgated after the 1950 Act, Assessment Decision No. 109, dealt specifically with the assessment of letters of credit issued in exchange for promissory notes. In pertinent part, it provided as follows:

> (b) Commercial[16] letters of credit normally are not sold for cash but are issued against an agreement to reimburse the bank for payments to be made by the bank under the letter of credit. The agreement may be contained in a written contract or it may rest in custom and usage. . . . *If such an agreement does not constitute a promissory note, the letter of credit issued upon such an agreement is not subject to assessment.*

12 C.F.R. § 327.209(b) (1956) (emphasis added). The inescapable implication of this statement, of course, is that

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16. Formerly, all letters of credit used in a commercial context, including those now called "standby" letters of credit, were simply referred to as "commercial" letters of credit. This was the case at the time Assessment Decision No. 109 was promulgated. See generally Comment, *Recent Extensions in the Use of Commercial Letters of Credit*, 66 Yale L.J. 902 (1957); McCurdy, *Commercial Letters of Credit*, 35 Harv. L. Rev. 539 (1922).

if the agreement *is* a promissory note, the letter of credit is subject to assessment and is insured. Assessment Decision No. 109 was the last pronouncement by the FDIC of its position on the question presented in this case prior to the enactment of Section 1813(*l*)(1). It completly undercuts the FDIC's reliance upon nonanalogous assessment decisions, 12 C.F.R. §§ 327.145, 327.148 (1959) (loan commitments), regulations, 16 Fed. Res. Bull. 520 (1930) (notes eligible for discount at Federal Reserve banks), and cases, *Gilman v. Commissioner*, 53 F. 2d 47 (8th Cir. 1931) (tax treatment of interest on note issued without consideration). Brief for Petitioner at 19, 25 n.20.

It seems impossible that a purportedly longstanding and consistent administrative interpretation could completely escape mention in the statute's legislative history, or in any of the regulations addressing the insured status of letters of credit. No doubt recognizing this, the FDIC characterizes its interpretation as "informal." Brief for Petitioner at 24. The FDIC's position in this litigation is at odds with the plain language of the statute, and has been directly contradicted in many of its own pronouncements on the issue. It has failed utterly to demonstrate a consistent administrative interpretation. There appear only "appellate counsel's *post hoc* rationalizations" (*Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 168 (1962)) of the FDIC's administrative inaction.

III. Affirmance Would Not Deleteriously Affect the Tax-Free Status of Municipal and Industrial Revenue Bonds, Nor Would It Burden the Banking System.

The FDIC and the *amici* who seek reversal have argued that affirmance of the decision below would cause uncertainty in the market for certain tax-free municipal and industrial revenue bonds, by adversely affecting their tax exemption. Brief for Petitioner at 29 *et seq.*; ABA Brief at 10-11; Brief for U.S. Conference of Mayors, *et al.*,

passim. These arguments about the supposed impact of affirmance are, presumably, the same arguments they will raise in legislative hearings on a bill recently introduced in Congress at the FDIC's request which would completely exclude letters of credit, whether "funded" or "unfunded," from Section 1813(*l*)(1)'s definition of "deposit."[17] Such arguments are addressed more toward whether it is necessary or prudent to insure "unfunded" standby letters of credit issued in exchange for promissory notes, rather than whether Section 1813(*l*)(1) commands such treatment. That suggests that Congress is far better equipped to evaluate the merits of such claims than is the Court, whose review is limited by the record and whose duty it is to give effect to the intent of Congress as expressed in the existing statute.

The FDIC and its *amici* point to the provision in the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 *et seq.*, that amended the Internal Revenue Code to provide that federally guaranteed industrial revenue bonds will lose their tax-exempt status. See 26 U.S.C. § 103(h). They speculate that revenue bonds backed by standby letters of credit for credit enhancement purposes could, if the decision below is affirmed, be treated by the Internal Revenue Service as "federally guaranteed" and so would not be exempt from taxation. Congress, they claim, assumed that standby letters of credit were not insured deposits when it enacted this legislation. Brief for Petitioner at 29-30; ABA Brief at 10-11; Brief for U.S. Conference of Mayors, *et al.* at 9-11. The principal basis for this claim is a post-enactment document prepared by the staff of the Joint Committee on Taxation, generally explaining the revenue provisions of the Deficit Reduction Act of 1984. Staff of Joint Comm. on Taxation, *General Explanation of*

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17. S. 760, 99th Cong., 1st Sess. (1985), *reprinted in* 131 Cong. Rec. S3466 (Mar. 26, 1985), now before the Senate Committee on Banking, Housing and Urban Affairs.

the Revenue Provisions of the Deficit Reduction Act of 1984, 98th Cong., 2d Sess. (Comm. Print 1984).

Plainly, an Act of Congress in 1984 provides almost no help in determining the intent of Congress in 1960, when Section 1813(*l*)(1) was passed, as "it is well settled that 'the views of a subsequent Congress form a hazardous basis for inferring the intent of an earlier one.' " *Russello v. United States*, 464 U.S. 16, 26 (1983), quoting *United States v. Price*, 361 U.S. 304, 313 (1960); see *Jefferson County Pharmaceutical Ass'n, Inc. v. Abbott Laboratories*, 460 U.S. 150, 165 n.27 (1983).[18] Here, the basis for the arguments of the FDIC and *amici* about Congress' intent in 1960 when it enacted Section 1813(*l*)(1) is especially weak. The staff explanation they rely upon postdates the enactment of Section 1813(*l*)(1) by more than twenty-four years, and postdates the legislation to which it relates, therefore lacking even what weight a pre-enactment committee report would have. As the Court has recognized, "[t]he less formal types of subsequent legislative history provide an extremely hazardous basis for inferring the meaning of a congressional enactment." *Consumer Product Safety Comm'n v. GTE Sylvania, Inc.*, 447 U.S. 102, 118 n.13 (1980).

The staff explanation also appears to be contradicted by the actual legislative history of the Deficit Reduction Act, which indicates that Congress in 1984 recognized that letters of credit can be insured deposits. The Supplemental Report of the House Ways and Means Committee explains an exception (now codified at 26 U.S.C. § 103(h)(3)(D)) to the general denial of tax exemption in this way:

18. This principle is to be distinguished from cases where Congress, in a statute, directly declares the intent of a former Congress. In such a case, unlike the present case, the Court has a clear and unequivocal statement by Congress about its earlier intent, and gives that statement "great weight in statutory construction." *Red Lion Broadcasting Co. v. Federal Communications Comm'n*, 395 U.S. 367, 380-81 (1969).

> Another exception to the general denial of tax-exemption provides that obligation shall not be treated as Federally guaranteed solely because . . . a financial institution guarantees repayment of the loans (*e.g.*, issues a letter of credit).

H.R. Rep. No. 432, Part II, 98th Cong., 2d Sess. 1690, *reprinted in* 1984 *U.S. Code Cong. & Ad. News* 697, at 1313. The Committee's explanation of the relevant exception therefore evidences its awareness that a standby letter of credit can be an insured deposit. The staff explanation, however, published five months after the enactment of the Deficit Reduction Act, explains the exception in a significantly different way:

> A further exception provides that obligations are not treated as federally guaranteed . . . solely because a financial institution guarantees repayment of the loans *other than by means of federal deposit insurance* (*e.g.*, by a letter of credit).

Staff of Joint Comm. on Taxation, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, 98th Cong., 2d Sess. 941 (1984) (emphasis added). Thus, the staff explanation differs from the actual committee report by implying that Congress did not believe that letters of credit are covered by deposit insurance, and that Congress meant to deny tax exemption to bond issues backed by standby letters of credit. The actual legislative history of the Deficit Reduction Act indicates that affirmance of the court of appeals' holding will not affect the tax-exempt status of such bond issues.

Numerous bond issues backed by standby letters of credit are still being closed, and many bond lawyers do not believe that the decision below adversely affects the tax-exempt status of the bonds. See Ferris, *FDIC Submits Bill to Congress to Protect Tax Exemption of Letter-Backed Bonds*, American Banker, April 2, 1985, at 11. Because

Section 1813(*l*)(1) defines a promisory note but not a reimbursement agreement as "money or its equivalent," affirmance of the court of appeals' decision will not suggest that bonds backed by standby letters of credit issued in exchange only for reimbursement agreements will lose their tax exemption.

Similarly, claims by the FDIC and its *amici* that the banking industry would be negatively affected by affirmance of the decision below are overstated and speculative. The FDIC has no records showing the number of standby letters of credit issued in exchange for promissory notes. FDIC Reply Memorandum in support of its Petition for *Certiorari*, at 4 n.3. At any rate, the effect on banks of assessing such letters of credit for deposit insurance premiums should be negligible, as the fee charged by the issuing bank to the account party for the issuance of the letter can be adjusted to reflect the additional cost of deposit insurance premiums. This additional cost would be only one-twelfth of one percent (0.083%), under 12 U.S.C. § 1817(b)(1), and if the issuing bank felt that even this slight increase would be significant for an account party, it could elect to issue the letter of credit in exchange for a reimbursement agreement instead of a promissory note. Nor does the treatment of certain letters of credit as deposits under the Federal Deposit Insurance Act mean that they would also have to be so treated for different purposes, such as for capital or reserve requirements. See, *e.g.*, 12 C.F.R. § 204.2(a)(1) (defining "deposit" differently from 12 U.S.C. § 1813(*l*) for reserve requirements).

In sum, the arguments raised by the FDIC and its *amici* about the supposed consequences of affirmance of the decision below carry very little weight, as they are speculative, overstated, and find no support in the record of this case. Although the arguments raise policy considerations that may have some substance, they require for their resolution the kind of fact-finding and balancing of

competing interests which is more the province of Congress than the Court. *Diamond v. Chakrabarty*, 447 U.S. 303, 317 (1980); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 344-45 (1979); *Tennessee Valley Authority v. Hill*, 437 U.S. 153, 194-95 (1978); *Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 156 n.12 (1976). The Court therefore should not be deterred by these arguments from applying the clear terms of Section 1813(*l*)(1) to the facts of this case.

CONCLUSION

This case presents a simple question of statutory construction, on which the district court and court of appeals agreed. There is no indication in the legislative history of 12 U.S.C. § 1813(*l*)(1), in the regulations issued by the FDIC, or in any other source that any departure from the clear statutory language is warranted. Respondent's letter of credit, the statute dictates, was issued for a promissory note that must be regarded as the equivalent of money, and so is an insured deposit. The decision of the court of appeals should be affirmed.

Respectfully submitted.

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REPLY

BRIEF

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No. 84-1972

In the Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION,
PETITIONER

v.

PHILADELPHIA GEAR CORPORATION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR THE PETITIONER

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Although respondent insists that the Penn Square letter of credit at issue in this case was an insured deposit, it has failed to take issue with most of the legal propositions established in our opening brief. Respondent thus does not deny that the federal deposit insurance system was intended only to protect things of value that are entrusted to banks. It nowhere suggests that the Orion note backing the Penn Square letter of credit had any present value, or otherwise was the equivalent of money. And respondent does not establish that the Federal Deposit Insurance Corporation (FDIC) ever has assessed an insurance premium on such an unfunded letter of credit, or otherwise has departed from its position—concededly articulated by the Corporation at the time of the promulgation of Regulation I in 1935—that such letters are uninsured. In these circumstances, respondent and its supporting amici have offered no reason to

believe that Congress would have wanted such letters to receive the benefits of federal deposit insurance.

1. At the outset, the Allen amici take issue with our statement of the aim of the federal deposit insurance program, insisting that the Banking Act of 1933, ch. 89, 48 Stat. 162 *et seq.*, had purposes in addition to the protection of funds entrusted to banks (Br. 7-9, 12). This undoubtedly is true; Congress plainly intended the Act to restore public confidence in the banking system generally, and in transactions turning on bank credit (see Gov't Br. 12-14). But this hardly means that Congress intended to *insure* all extensions of bank credit. To the contrary, as amici themselves recognize (Br. 8), Congress found as the root of the Depression-era banking crisis the fact that "[t]he public is afraid to deposit their money in the banks, and the banks are afraid to employ their deposits in the extension of bank credit for the support of trade and commerce." H.R. Rep. 150, 73d Cong., 1st Sess. 6 (1933). Thus, as one of the Act's sponsors explained:

> We cannot have a normal use of bank credit in the United States until people are willing to put their deposits in banks. Deposits constitute the basis for bank credit, and bankers can never be free to extend credit accommodations for the support of trade and commerce until they are permitted to retire at night without fear of mobs at their doors the next morning demanding cash for their deposits.

77 Cong. Rec. 3839 (1933) (remarks of Rep. Steagall).

It is for this reason, of course, that Congress chose to address the public's lack of confidence in the banking system through the creation of a system of deposit, rather than of credit, insurance. And it is for this reason that Congress basically defined the term "deposit" to include "money or its equivalent received or held by a bank." 12 U.S.C. 1813(*l*)(1);

see 12 U.S.C. 1813(*l*)(2)-(5). Despite the skepticism of amici, it hardly seems necessary to belabor the point: if the bank's customer has not entrusted the bank with something of value, the customer has not made a deposit that is protected by deposit insurance coverage if the bank fails.[1]

2. a. For its part, respondent evidently does not take issue with the proposition established above, acknowledging (see Br. 11) that the crucial question for deposit insurance purposes is whether the bank received money or its equivalent from its customer. But respondent entirely fails to answer that question here. Instead, it devotes much of its brief to misstating the nature of our submission, reading our opening brief to contend that a letter of credit may be insured only if it is supported by funds directly credited by the bank to the customer's (or to a special) account. Such an approach, respondent continues, would read the promissory note proviso out of Section 1813(*l*)(1), because it effectively would permit a letter of credit to represent a deposit only if the letter is issued in exchange for cash. Resp. Br. 12-14 & n.8.

In fact, we fully agree with respondent that the determinative question does not concern the *disposition* of the money or its equivalent received by a bank in exchange for a letter of credit. The focus of the deposit insurance program, instead, is on *what* the bank receives from its customer. It is

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[1]Congress's inclusion of cashier's checks, money orders, and the like within the definition of deposit (12 U.S.C. 1813(*l*)(4)) is hardly inconsistent with this principle, as respondent (Br. 15) and the Allen amici (Br. 10) assert. In the normal course of business, a bank insists on receiving payment before issuing such an instrument, because it assumes an immediate obligation to make payments on the instrument; for that reason, such instruments are included in the definition of deposit for reserve purposes. 12 C.F.R. 204.2(a)(i)-(iii). It thus can be safely assumed that a bank issuing an instrument of that type has received money or its equivalent in exchange.

only when the bank is entrusted with money or its equivalent that a "customer who delivers his own funds to the bank risks their total or partial loss if the bank should suspend operations" (*FDIC* v. *Irving Trust Co.*, 137 F. Supp. 145, 162 (S.D.N.Y. 1955)), and it accordingly is only in those circumstances that a deposit is created. Thus, as one commentator recently has observed, "from the standpoint of deposit insurance law," the hallmark of a note that is the equivalent of money "is nothing short of its convertibility to currency by the depository bank prior to the bank's payment of the standby [letter of credit]." 2 Gov't Information Servs., *Letter of Credit Update* 23-24 (Jan. 1986) (remarks of Prof. Kozolchyk).[2] The central flaw in respondent's argument is its failure to establish that Orion's contingent back-up note was in fact the equivalent of money.

Respondent (Br. 17-18) and the Allen amici (Br. 12-16) argue at considerable length that a contingent note of the sort at issue here serves as a useful mechanism to guarantee that a bank will be reimbursed for the funds that it pays out on a standby letter of credit. This may well be true—although, depending upon its terms, such a note may be no more useful in serving this purpose than would be a simple reimbursement agreement that concededly does not give rise to an insured deposit when received by a bank in exchange for a letter of credit.[3] But whatever its validity,

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[2]"To become a balance in favor of the depositor, the note, regardless of its negotiability, must mature and be collectible from an outside source or from an account with the issuing bank, prior to the maturity of the letter of credit." Gov't Information Servs., *supra*, at 24 (remarks of Prof. Kozolchyk).

[3]This is the case, for example, of notes in the form of the one at issue in the *Allen* litigation. *Allen* v. *FDIC*, 599 F. Supp. 104, 105 (E.D. Tenn. 1984), appeal pending, No. 85-5003 (6th Cir.) (citation omitted) (note providing that bank's customer would pay " 'such amount(s) as the Bank may be required to disburse on behalf of [the customer] on account of [the] Letters of Credit' "). Indeed, in many cases the value of a back-up note securing a standby letter of credit will be wholly illusory, because the customer by definition already has defaulted on its obligation to the beneficiary of the letter before the note is called upon (see Gov't Br. 3 n.1); in such circumstances, the bank's ability to collect on the note is likely to be considerably less than certain. See *Regulation of Standby Letters of Credit: Hearing on S. 2347 Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 2d Sess. 256 (1976) [hereinafter cited as *Senate Hearing*] (statement of Federal Reserve Board staff) ("[i]n many cases, the financial condition of the customer is apt to be unsatisfactory at the time when a standby letter is used, as evidenced by its default on the underlying business transaction"); cf. *id.* at 174 (statement of Independent Bankers Association of America) (payments made under a standby letter on behalf of a bank's customer are "of questionable value [to the bank] since they are made only when the holder of the letter has already defaulted to a third party").

respondent's proposition is beside the point. As we explained in our opening brief (at 16-17), a contingent note such as Orion's creates no present indebtedness; Penn Square could not have obtained value for Orion's note, could not have offset it against any obligation that it had to Orion, and could not have sued on Orion's obligation. Respondent nowhere disputes this. And this implicit concession is fatal to respondent's argument, for such a note is in no sense the equivalent of money.

b. At bottom, respondent accordingly hinges its argument on the assertion that the Court may not consider the actual value of the instrument that Orion entrusted to the bank because that instrument purported to be a promissory note. Respondent contends (Br. 17-18, 19) that this approach is supported by a literal reading of Section 1813(*l*)(1), asserting that the question here is settled by the statutory proviso that a letter of credit "must be regarded as evidencing the receipt of the equivalent of money" when issued in exchange for a "promissory note." But Congress enacted Section 1813(*l*)(1) to protect deposits, not to permit clever draftsmen to insure their business transactions by using the proper form of words in drafting their reimbursement

agreements. The instruments listed in the proviso to Section 1813(*l*)(1) as representing the equivalent of money—including promissory notes—are thus illustrative, serving to establish that the protections of deposit insurance extend to all things of value (rather than only cash) that have been entrusted to banks.[4] And a contingent back-up note, whether or not it has the term "promisory note" printed across the top, is in no meaningful sense the equivalent of money.

Moreover, as we explained in our opening brief (at 18-19), the administrative drafters of the promissory note proviso would have recognized that, for a variety of purposes, federal law at the time of the promulgation of Regulation I did not recognize a contingent instrument to be a "promissory note." Here as well, the statutory reference to promissory notes plainly was intended to encompass uncontingent instruments that are in fact the equivalent of money. Neither respondent nor the Allen amici have offered any reason to believe that Congress intended to depart from this sensible approach.[5]

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[4]The history of the proviso makes it plain that the various instruments listed there have significance only because Congress believed them to be the equivalent of money. As originally promulgated in 1935, the FDIC's Regulation I, the predecessor to Section 1813(*l*)(1), did not define the term "money or its equivalent." See 1935 FDIC Ann. Rep. 90-91. On October 1, 1935, the FDIC's Board of Directors issued an "Interpretation of the Words 'its equivalent' in Section 2 of Regulation I." *Ibid.* This interpretation set out the language of the current proviso, which was incorporated into the regulation (see 12 C.F.R. 326(d) (1959)) and ultimately into Section 1813(*l*)(1).

[5]The Allen amici suggest (Br. 11-12 n.6) that the Orion back-up note would be viewed as a promissory note as a matter of state commercial law. Whether the Orion note is a "promissory note" within the meaning of Section 1813(*l*)(1), however, plainly involves a question of federal law (see generally *D'Oench, Duhme & Co.* v. *FDIC*, 315 U.S. 447, 456-462 (1942); *First National Bank* v. *Dickinson*, 396 U.S. 122, 133-134 (1969)), which must be answered in a manner consistent with the statutory purpose. See *id.* at 134.

3. Respondent's second argument (Br. 20-32)—that the FDIC's distinction between funded and unfunded letters of credit is newly developed or has been applied inconsistently, and thus is not due deference—also is flawed. Although respondent contends that the 1935 transcript cited in our opening brief (at 24) is entitled to little weight (Resp. Br. 15-16 n.9), it cannot deny that the transcript represents a contemporaneous construction by the drafters of Regulation I declining to treat unfunded letters of credit as deposits. And while respondent (Br. 28-32; see Allen Am. Br. 16-17) insists that the FDIC failed to recognize the distinction between funded and unfunded letters of credit prior to this litigation, it does not suggest that the FDIC ever has assessed insurance premiums on such letters, or paid out on claims relating to such letters. This obviously involved more than administrative "inattention" (Allen Am. Br. 20); given the more than $100 billion worth of standby letters of credit outstanding,[6] the FDIC's failure to assess premiums on

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[6]Respondent is incorrect in stating (Br. 29-30 n.15; see Allen Am. Br. 16-17) that the FDIC's estimate of the number of oustanding unfunded standby letters of credit—or its position in this litigation—has been inconsistent. Virtually all standby letters of credit are unfunded. See *Senate Hearing* 6 (letter from First Deputy Comptroller Robert Bloom to Sen. Proxmire) ("[i]n the context of a standby letter of credit, there is no deposit made by beneficiary of the letter of credit"); *id.* at 17 (letter from Federal Reserve Board to Sen. Proxmire) ("a bank issuing a[] [standby letter of credit] [does] not receive funds in the amount of the [standby letter of credit]"). Our opening brief (at 27) (in contrast to our petition for certiorari and our brief before the court of appeals) accordingly referred to "unfunded" standby letters of credit simply for reasons of clarity.

Indeed, the Federal Reserve Board and FDIC record "standby letters of credit" in the category of off-balance sheet liabilities, rather than in the category of deposit liabilities for which banks have received funds. As of December 31, 1983, the published records of these agencies disclosed that there were just under $100 billion worth of standby letters of credit outstanding (Board of Governors of the Federal Reserve

these instruments plainly manifests a consistent, considered judgment that standby letters of credit are uninsured.

Respondent's further attempt to demonstrate inconsistency in the FDIC's regulatory approach (Br. 31-32) turns on the quotation of out-of-context snippets of the regulatory history. The 1955 amendment to Regulation I, which respondent cites (Br. 31) for the proposition that all letters of credit were to be insured, simply reversed the order of the words "traveler's checks and letters of credit." 12 C.F.R. 326.1(c) (1957). The obvious purpose of this amendment was to make it clear that the word "traveler's" did not modify the term "letter of credit," a reading that would have limited insurance coverage to traveler's letters of credit. Cf. 12 C.F.R. 327.210 (1959). The FDIC thus explained that this "change in the wording" of the regulation was "a clarification of the consistent interpretation by the Corporation of the term 'letters of credit' to include all letters of credit *issued under the circumstances stated in this paragraph.*" 12 C.F.R. 326.1(c) n.2 (1959) (emphasis added). These "circumstances," of course, involved letters issued for money or its equivalent, or for a charge against a deposit account. 12 C.F.R. 326.1(c)(1) and (2) (1959).[7]

System, *Annual Statistical Digest* 71 (1983); FDIC, *1983 Statistics on Banking* 62); as we explained in our opening brief (at 28 n.22), the $120 billion figure cited in that brief and in our petition for certiorari had been updated by reference to call reports submitted to the FDIC by banking institutions. The $450-500 billion figure mentioned in our brief before the court of appeals referred not to the number of standby letters of credit currently outstanding, but to the number of standby letters of credit issued over the past five years.

[7]That the FDIC did not intend to insure standby letters of credit is confirmed by the history of the standby device. Standby letters were used relatively infrequently prior to the 1960's. Cf. Harfield, *The Increasing Domestic Use of the Letter of Credit*, 4 U.C.C. L.J. 251, 258 (1972); Comment, *The Independence Rule in Standby Letters of Credit*, 52 U. Chi. L. Rev. 218, 219 & n.14 (1985). As their use became more common, the FDIC took the position in 1968 that the issuance of such

Respondent also points (Br. 31-32) to an assessment decision issued by the FDIC in 1956. But that decision, later incorporated into a regulation, in fact articulated the distinction between funded and unfunded letters of credit. Part (a) of the regulation (12 C.F.R. 327.209(a) (1959)) provided that letters of credit "issued in exchange for checks or drafts or for a promissory note" would be treated as insured. Part (b) (12 C.F.R. 327.209(b) (1959)) provided that unfunded letters backed only by "an agreement to reimburse the bank for payments to be made by the bank under the letter of credit" would be *uninsured* unless the reimbursement agreement "constitute[d] a promissory note." And as explained above, a back-up note plainly does not constitute a promissory note for purposes of the deposit insurance program.[8]

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letters by banks should be proscribed as an unsound banking practice unless the bank "had a segregated deposit sufficient in amount to cover its potential liability under the standby letter of credit." See *Senate Hearing* (letter from FDIC Chairman Frank Wille to Sen. Proxmire). While the FDIC abandoned this position several years later (see *id.* at 20-21), it is hardly likely that the Corporation intended to insure an instrument that it had once hoped to proscribe altogether.

[8]Indeed, the distinction betwen funded and unfunded letters is so fundamental that it has been recognized by the Federal Reserve Board and the Comptroller of the Currency, as well as the FDIC, in regulations treating funded letters as deposits and unfunded letters as so-called off-balance sheet contingent liabilities (see Gov't Br. 16 n.11, 20-21 n.14). Some 10 years ago, the agencies emphasized the distinction between the two types of instruments in testimony opposing a bill that would, among other things, have aggregated standby letters of credit with bank deposits for reserve purposes. S. 2347, 94th Cong., 2d Sess. (1976). See *Senate Hearing* 7 (letter from First Deputy Comptroller Robert Bloom to Sen. Proxmire); *id.* at 9-10 (letter from Reserve Board Chairman Arthur Burns to Sen. Proxmire) ([redacted]). The bill was not enacted.

4. Respondent finally takes issue with our reading of the Deficit Reduction Act of 1984 (DEFRA), Pub. L. No. 98-369, 98 Stat. 494 *et seq.* (see Gov't Br. 26 n.21, 29-30), which we suggested points up Congress's current understanding that standby letters of credit are not insured. DEFRA provides that a state or local obligation will lose its tax exempt status if it is federally-guaranteed (§ 622, 98 Stat. 919 (to be codified at 26 U.S.C. 103(h)(1) and (2)), while adding the proviso that "an obligation * * * shall not be treated as federally guaranteed merely by reason of the fact that * * * there is a guarantee by a financial institution." § 622 (to be codified at 26 U.S.C. 103(h)(3)(D)). As respondent (Br. 35) and the Allen amici (Br. 24) acknowledge, the report of the Joint Committee on Taxation regarding this provision indicates the congressional view that obligations backed by standby letters of credit fall within this proviso (and thus are not federally-guaranteed) because standby letters of credit are not covered by federal deposit insurance. See Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984*, at 941 (Comm. Print 1984).[9]

Respondent contends, however, that the Joint Committee misunderstood the legislation. Instead, respondent looks for guidance (Br. 35; see Allen Am. Br. 23) to the report of the House Ways and Means Committee, which commented as to the House bill's version of Section 622 that "obligation[s] shall not be treated as Federally guaranteed solely because * * * a financial institution guarantees repayment of the loans (*e.g.*, issues a letter of credit)." H.R. Rep. 98-432, 98th Cong., 2d Sess. Pt. 2, at 1690 (1984).

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[9]The Joint Committee stated (at 941) that "obligations are not treated as federally guaranteed * * * solely because a financial institution guarantees repayment of the loans other than by means of Federal deposit insurance (e.g., by a letter of credit)."

Respondent reads this to signal Congress's recognition that letters of credit *are* insured, as well as a congressional intent nevertheless to preserve the tax exempt status of bonds backed by insured letters of credit.

This analysis plainly is far-fetched. The focus of Congress's concern during the debate on Section 622 was the use of federal deposit insurance to protect tax free bonds. Against this background, the House report cited by respondent can most naturally be read—as the Joint Committee report specifically states—as recognizing that standby letters of credit are not federally-insured. This reading also avoids the anomalous conclusion that the Joint Committee failed to understand the intent of the legislation that it set out to explain.[10] And if this was the view of Congress, it plainly has probative value in ascertaining the meaning of Section 1813(*l*)(1). See, *e.g.*, *Bell* v. *New Jersey*, 461 U.S. 773, 784-785 (1983); *Seatrain Shipbuilding Corp.* v. *Shell Oil Co.*, 444 U.S. 572, 596 (1980).

For the foregoing reasons and the reasons stated in our opening brief, the judgment of the court of appeals should be reversed.

Respectfully submitted.

CHARLES FRIED
Solicitor General

FEBRUARY 1986

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[10]Indeed, Congress evidently believed in 1976 that standby letters of credit are not deposits for reserve purposes under existing law; Congress otherwise would have felt no need to entertain legislation (see note 8, *supra*)—which was not, in any event, enacted—that would have aggregated standby letters with deposits for that purpose.

AMICUS CURIAE

BRIEF

MOTION FILED
JUL 19 1985

No. 84-1972

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

FEDERAL DEPOSIT INSURANCE CORPORATION,

Petitioner

v.

PHILADELPHIA GEAR CORPORATION,

Respondent

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE* AND BRIEF *AMICUS CURIAE* OF THE COUNCIL ON INTERNATIONAL BANKING, INC. IN SUPPORT OF PETITION FOR CERTIORARI

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ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

MOTION FOR LEAVE TO FILE BRIEF *AMICUS CURIAE*

Pursuant to Rules 36 and 42 of the Rules of this Court, the Council on International Banking, Inc. ("CIB") respectfully moves this Court for leave to file the brief *amicus curiae* annexed hereto. The consent of the Solicitor General, which represents petitioner, has been obtained but the attorney for the respondent refused to consent to the filing of a brief by CIB as *amicus curiae*.

Interest of Amicus Curiae

The CIB is a not-for-profit corporation, organized under the New York Not-For-Profit-Corporation Law, which is dedicated

to the promotion and development of sound and efficient international banking operations. It and its predecessors have been in continuous existence since 1924. Its membership consists of over 335 money center, regional and community banks located in New York City and throughout the eastern United States. The membership includes virtually all of the banks in the eastern United States which conduct significant international operations. Its members have issued billions of dollars of standby letters of credit, some of which are backed by promissory notes of the kind at issue here. It has affiliated organizations in the mid and far west and is the only organization of its kind.

The CIB actively seeks development, recognition and acceptance of uniform procedures, formats, forms, automated systems and the settelment of mutual problems. It seeks also further to educate its members on the operational and technical problems in international banking and to solve these problems. It sponsors seminars, publishes guides and responds to specific inquiries involving bank operations. The representatives of its members are responsible for the day to day conduct of their banks' operations.

The CIB has long taken an active interest in the subject of letters of credit. Its separate committee on letters of credit, composed of experienced bankers prominent in their field, meets at least once monthly to review developments in the field and to recommend industry-wide solutions to particular problems. These solutions often become the industry standard.

Given the minimum documentation, inherent time pressures, and large dollar amounts at stake, the letter of credit requires a uniform understanding by all who utilize it. The definition of what a letter of credit is and the consequences of issuing one are of paramount interest and concern to the CIB and its members.

The sole issue addressed by the CIB on this motion is whether a standby letter of credit represents a deposit as defined in 12 U.S.C. §1813(l)(1) when the issuing bank's customer (the account party) gives the bank a "contingent note" with the understanding that nothing will be considered due on the note unless and until the letter of credit is actually drawn upon. The United States

Court of Appeals for the Tenth Circuit held that such a letter of credit does represent a deposit for the purpose of 12 U.S.C. §1813(l)(1).

The FDIC may assess banks deposit insurance premiums for their standby letters of credit supported by "contingent notes" unless the lower court decision is overturned. In addition there is a possibility of such letters of credit becoming classified as deposits for other purposes such as reserve requirements. The result for CIB members and other banks may be exposure to millions of dollars of additional expense which would neither enhance the financial soundness of the banking industry nor provide additional protection for bank depositors.

The annexed brief *amicus curiae* demonstrates that the Court of Appeals' holding is contrary to the meaning and purpose of the Federal Deposit Insurance Act (the "Act"), a fifty years standing interpretation of the FDIC, the commercial reality of the transaction at issue, the weight of judicial authority, common understanding and centuries of commercial and financial practice.

Conclusion

For the reasons set forth above and in the annexed brief, the CIB requests leave to file the annexed brief as *amicus curiae*.

Respectfully submitted,

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No. 84-1972

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BRIEF *AMICUS CURIAE* OF THE COUNCIL ON INTERNATIONAL BANKING, INC. IN SUPPORT OF PETITION FOR CERTIORARI

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QUESTION PRESENTED

Does an unfunded standby letter of credit supported by a "contingent note" represent a "deposit" as defined in 12 U.S.C. §1813(l)(1)?

PARTIES TO THE PROCEEDING BELOW

All of the parties appearing before the United States Court of Appeals for the Tenth Circuit are listed in the caption.

No. 84-1972

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

FEDERAL DEPOSIT INSURANCE CORPORATION,

Petitioner

v.

PHILADELPHIA GEAR CORPORATION,

Respondent

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF *AMICUS CURIAE* OF THE COUNCIL ON INTERNATIONAL BANKING, INC. IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Council on International Banking, Inc. ("CIB") hereby submits its brief *amicus curiae* in support of the petition for writ of certiorari filed by petitioner Federal Deposit Insurance Corporation ("FDIC") on June 19, 1985 in the captioned petition from a judgment of the United States Court of Appeals for the Tenth Circuit entered on December 27, 1984, upholding a decision by the United States District Court for the Western District of Oklahoma that an unfunded standby letter of credit supported by a "contingent note" represents a "deposit" under the Federal Deposit Insurance Act (the "Act").

OPINIONS BELOW

The opinion of the Tenth Circuit Court of Appeals is reported in 751 F.2d 1131. The opinion of the U.S. District Court for the Western District of Oklahoma is reported in 587 F.Supp. 294.

JURISDICTION

This Court has jurisdiction over the petition for writ of certiorari under 28 U.S.C. §1254(1) because the United States Court of Appeals for the Tenth Circuit has decided an important question of federal law involving the construction of the term "deposit" under the Federal Deposit Insurance Act which has not been, but should be, settled by this Court. Judgment was entered on December 27, 1984. A petition for rehearing, timely filed by the FDIC, was denied on February 19, 1985. On May 10, 1985, Justice White extended the time within which to file a petition for a writ of certiorari to June 19, 1985.

PARTIES TO THE PROCEEDING BELOW

All of the parties appearing before the United States Court of Appeals for the Tenth Circuit are listed in the caption.

STATUTORY PROVISIONS INVOLVED

This case calls upon the Court to construe the meaning of the term "deposit" as it is defined under the Federal Deposit Insurance Act in 12 U.S.C. §1813(l)(1).

The text of §1813(l)(1) is set out in Appendix A.

INTEREST OF COUNCIL ON INTERNATIONAL BANKING

The Council on International Banking, Inc. ("CIB") is a not-for-profit corporation, organized under the New York Not-For-Profit-Corporation Law, which is dedicated to the promotion and development of sound and efficient international banking operations. It and its predecessors have been in continuous existence since 1924. Its membership consists of over 335 money center,

regional and community banks located in New York City and throughout the eastern United States. The membership includes virtually all of the banks in the eastern United States which conduct significant international operations. It members have issued billions of dollars of standby letters of credit, some of which are backed by promissory notes of the kind at issue here. It has affiliated organizations in the mid and far west and is the only organization of its kind.

The CIB actively seeks development, recognition and acceptance of uniform procedures, formats, forms, automated systems and the settlement of mutual problems. It seeks also further to educate its members on the operational and technical problems in international banking and to solve these problems. It sponsors seminars, publishes guides and responds to specific inquiries involving bank operations. The representatives of its members are responsible for the day to day conduct of their banks' operations.

The CIB has long taken an active interest in the subject of letters of credit. Its separate committee on letters of credit, composed of experienced bankers prominent in their field meets at least monthly to review developments in the field and to recommend industry-wide solutions to particular problems. These solutions often become the industry standard.

Given the minimum documentation, inherent time pressures, and large dollar amounts at stake, the letter of credit requires a uniform understanding by all who utilized it. The definition of what a letter of credit is, how it operates and the consequences of issuing one are of paramount interest and concern to the CIB and its members.

The sole issue addressed by the CIB on this motion is whether standby letters of credit represent deposits as defined in 12 U.S.C. §1813(l)(l) when the issuing bank's customer (the account party) gives the bank a "contingent note" with the understanding that nothing will be considered due on the note unless and until the letters of credit are actually drawn upon. The United States Court of Appeals for the Tenth Circuit held that such a letter of credit does represent a deposit for the purpose of 12 U.S.C. §1813(l)(1).

The FDIC may assess banks deposit insurance premiums for their standby letters of credit supported by "contingent notes" unless the lower Court decision is overturned. In addition there is a possibility of such letters of credit becoming classified as deposits for other purposes such as reserve requirements. The result for CIB members and other banks may be exposure to millions of dollars of additional expense which would neither enhance the financial soundness of the banking industry nor provide additional protection for bank depositors.

STATEMENT OF THE CASE

Respondent in this case is the beneficiary of an irrevocable standby letter of credit issued on April 23, 1981 by Penn Square Bank, N.A. ("Penn Square") upon the application of Orion Manufacturing Corporation ("Orion"), a customer of the respondent. Penn Square issued the letter of credit without the deposit of any funds by Orion. All that Penn Square obtained was an unsecured, "contingent note" which matured on the day the letter of credit expired. No interest was to be charged and nothing was to be due on this note prior to presentation of the documents required under the letter of credit. The understanding between the parties was that Penn Square would have no claim against Orion unless and until the bank was called upon to make an advance under the letter of credit. Thus, no actual indebtedness existed at the time the "contingent note" was delivered.

On July 5, 1982, the Comptroller of the Currency declared Penn Square insolvent and respondent thereafter sought payment under the letter of credit. The FDIC, in its capacity as receiver, stated that it had no obligation under the letter of credit. The respondent then sued the FDIC in its capacity as insurer for deposit insurance proceeds, claiming that the letter of credit represented a deposit as the term is defined in 12 U.S.C. §1813(1)(1) of the Federal Deposit Insurance Act.*

* The respondent also sued the FDIC in its capacity as receiver for the alleged total uninsured outstanding balance of the letter of credit. That claim is not the subject of the FDIC's petition for certiorari.

The United States District Court for the Western District of Oklahoma held that the letter of credit did represent a deposit. *Philadelphia Gear Corporation v. F.D.I.C.*, 587 F. Supp. 294 (W.D. Okla. 1984). The FDIC appealed to the Tenth Circuit Court of Appeals which affirmed the District Court's holding.

The case turns upon the meaning of the term "deposit" in 12 U.S.C. §1813 (l)(1).

SUMMARY OF ARGUMENT

The Act clearly envisions that standby letters of credit do not represent "deposits" because only those letters of credit upon which a bank is "primarily liable" are included within the scope of the term. Despite the fact that it is well-established that standby letters of credit are, in substantial respects, functionally equivalent to guaranty contracts and create only contingent bank liabilities, the Court of Appeals in effect concluded that all letters of credit create a primary liability for purposes of the Act. In so doing, the court ignored the nature of standby letters of credit and disregarded the Act's use of the qualifying term "primarily liable."

The receipt of the note at issue in this case is not a deposit as the term is defined under the Act because it represents nothing more than additional evidence of a conditional promise to Penn Square and not a present indebtedness. No thing of value was entrusted to Penn Square and thus no thing of value was lost when Penn Square became insolvent. Since the purpose of the Act is to prevent the loss of entrusted funds due to bank insolvency, the payment of insurance proceeds by the FDIC in this case would conflict with the basic purpose of the Act. It would in fact create a windfall for a recipient who has sustained no loss due to bank insolvency and might force banks to pay insurance for "deposits" which were in reality never made.

Moreover, the statute's provision that a letter of credit represents a deposit when issued "in exchange for" a promissory note is further indication that the transaction involved here did not involve a deposit. No such exchange occurred in this case. Rather, the

note merely further evidenced a contingent obligation of Orion to Penn Square which arose by operation of law. The note itself did not create this obligation. It conferred no additional rights upon Penn Square. In fact, the letter of credit was issued in exchange not for a "contingent note" but presumably for a fee together with the established legal obligation of Orion to reimburse Penn Square which would arise when the letter of credit was drawn upon.

The FDIC drafted the language defining the term "deposit" in the Act as well as substantial portions of the balance of the Act. Given this fact, its substantial experience with the administration of the Act, and its intimate knowledge of commercial banking, the FDIC's interpretation of the term is entitled to great deference.

The FDIC has, for fifty years, consistently interpreted the term "deposit" to exclude letters of credit which are not secured by evidence of present indebtedness. Congress was aware of this interpretation when it enacted the FDIC's language in 1960 and should therefore be presumed to have adopted the FDIC's interpretation of the term. In addition, insured banks have relied heavily upon the FDIC's consistent interpretation of the statute.

Not only has the FDIC held to this view but the commercial world has never regarded the letter of credit as more than a commercial tool to effectuate payments. This has been the function of the letter of credit for centuries. To now construe it as giving rise to a deposit even if the statutory language would support such a reading is contrary to long and widely held understanding of what a letter of credit is and is not.

ARGUMENT

I. An unfunded standby letter of credit supported by a "contingent note" does not represent a "deposit" as defined in 12 U.S.C. §1813(l)(l).

a. A standby letter of credit is not a primary bank liability.

A "deposit" is defined under the Act to include "the unpaid balance of money or its equivalent...evidenced by...a letter of credit...on which the bank is primarily liable...." 12 U.S.C. §1813(l)(1). The Court of Appeals' holding that the bank was "primarily liable" on the standby letter of credit disregards the specific intent of §1813(l)(1). The definition of the term "deposit" in that section contemplates that there exist certain letters of credit upon which a bank is only secondarily liable. If all letters of credit were intended to be included, no such qualifying language would be necessary.

A standby letter of credit is a secondary — not a primary — bank liability. While the bank becomes primarily liable once the contingency which the standby letter of credit was issued to cover occurs, the letter of credit itself and thus the issuing bank's obligation thereunder is secondary or contingent to the obligation of the obligor in the underlying transaction. The bank's function with respect to a standby letter of credit is to act as a surety for its customer's failure to pay the primary obligation. "The bank is, in essence, secondarily liable, a conceptual distinction that separates the [standby] letter of credit from the traditional letters of credit and might justify the application of different rules of law." Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716 (1973).

Unlike other letters of credit, the standby letter of credit is, as the Court of Appeals acknowledged, similar in many respects to a surety's contract to guaranty a principal's debt. A recent decision by the United States Court of Appeals for the Fifth Circuit recognized this fact by holding that a standby letter of credit is a contingent and not a primary deposit liability. *In Re F & T*

Contractors, Inc., 718 F.2d 171 (6th Cir. 1983). Numerous commentators have also recognized that standby letters of credit are, in substantial respects, functionally equivalent to guaranty contracts. Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan.L.Rev. 716 (1973); Lord, *The No-Guaranty Rule and the Standby Letter of Credit Controversy*, 96 B.L.J. 46 (1979); Harfield, *The Standby Letter of Credit Debate*, 94 B.L.J. 293 (1977); Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, (Pts. 1-2), 85 U.Pa.L.Rev. 175, 261 (1936-1937).

This functional similarity between standby letters of credit and guarantees has been recognized and codified by the Comptroller of the Currency in regulations imposing lending limitations on national banks. 12 C.F.R. §32.2(d). That provision specifically includes within the definition of loans and extensions of credit "an obligation to guarantee or stand as surety for the benefit of a third party. The term includes...standby letters of credit... guarantees...and other similar arrangements.... The definition does not include commercial letters of credit and similar instruments...."

As more fully discussed below in section II, the FDIC has held to this fundamental distinction between standby and other letters of credit for fifty years and its construction has been confirmed by commentators, case law and regulation.

The Court of Appeals' reasoning to the contrary is fallacious. In reaching the conclusion it did, the court relied upon the fact that once a bank becomes liable under a standby letter of credit, it has almost no real defenses. The bank may only dishonor a claim if the presented documents contain irregularities and thus faces nearly absolute liability. This is by definition true of all letters of credit (U.C.C. §5-114(1) (1985); *cf.* Uniform Customs and Practice for Documentary Credits, general provisions and definitions, (1983 Revision), International Chamber of Commerce Publication No. 400) but does not settle the question of whether the issuing bank's "primary liable" within the meaning of the statute. It merely means that once the contingency invoking the bank's liability occurs, the bank is liable on its agreement to pay, which in the standby letter of credit context is secondary to the primary obligation of another. The court's construction disregards this distinction, which is drawn in the statue itself by the use of the

phrase "primarily liable" and thus contravenes one of the cardinal principles of statutory interpretation, i.e. that significance and effect should if possible, be accorded every word of an act. *McDonald v. Thompson*, 305 U.S. 263 (1938), *reh'g denied*, 305 U.S. 676 (1939).

b. An unfunded standby letter of credit supported by a "contingent note" does not evidence receipt of "money or its equivalent" under 12 U.S.C. §1813(l)(1) because the "contingent note" is not a "promissory note" within the meaning of that section.

As noted earlier, a deposit is defined under the Act as, *inter alia*,

> the unpaid balance of money or its equivalent received or held by a bank...which is evidenced by a letter of credit... *Provided*, That, without limiting the generality of the term "money or its equivalent", any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks, or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable. 12 U.S.C. §1813(l)(1).

The Court of Appeals held that the standby letter of credit at issue was issued in exchange for a "promissory note" and that the letter of credit therefore evidenced "money or its equivalent."

Nothing in the Act itself nor in the legislative history expressly defines the scope of the term "promissory note" and the Court of Appeals did not attempt to define the term. Rather, it appears to have merely relied on the fact that the "note" was a "form note with standard terms." 751 F.2d at 1135. In so doing, it apparently assumed that the term "promissory note" should include all notes. Yet it is well-established that the manifest intent of the Congress must prevail over the common definition of specific words. *Minnesota Mining & Mfg. Co. v. New Jersey Wood Finishing Co.*, 381 U.S. 311 (1965); *Fleischmann Constr. Co. v. U.S.*, 270 U.S. 349 (1925); *Shelby v. Guy*, 24 U.S. 361 (1826). This principle is crucial here since the lower court's approach clearly operates to defeat the purpose of the Act.

The Act was "designed to prevent the destruction of deposits because of bank failure and to protect depositors against loss." S. Rep. No. 1821, 86th Cong., 2d Sess. (1960) *reprinted in* 1960 U.S. Cong. & Ad. News 3234. In other words, it was intended to protect those who entrust funds to a bank against the risk that the bank will become insolvent. It is crystal-clear, in the present context, that Orion's "note" cannot seriously be considered an entrustment of funds with Penn Square. Penn Square and Orion understood that nothing would be considered due on the note and no interest would be charged unless and until the letter of credit was acted on by the beneficiary. The bank extended no funds to anyone. The "transaction" was not a transfer of money or its equivalent, but rather at most an exchange of various conditional promises. No present indebtedness existed. From the perspective of both Penn Square and Orion, the transaction merely created a contingent liability. Since the conditions underlying these promises did not occur prior to, or by reason of, Penn Square's insolvency, no deposited funds were lost as a result of the insolvency.*

If the note is nevertheless treated as an insured deposit, Orion (through its beneficiary, the respondent) will enjoy a windfall because it will have been "reimbursed" by federal deposit insurance even though it never made a deposit with Penn Square. It cannot be seriously be contended that Congress intended such a novel and clearly unfair result.

The legislative history of the Act further indicates that Congress intended the term "promissory note" to have a limited construction. During Congressional hearings on the 1960 amendments which adopted the language of the FDIC'S Regulation I, the first detailed definition of the term "deposit", the FDIC made it clear that not every promissory note creates a deposit

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* The Court of Appeals' holding that a contingency which occurs after insolvency may be treated as creating a provable claim does not effect this conclusion. The court was not addressing the cause of the loss but rather the timing of the loss. The court's holding on this issue assumes that the item involved is a deposit. *Philadelphia Gear Corporation*, 751 F.2d at 1138.

liability under Regulation I. The FDIC stated that a promissory note received by the bank as security against a loan does not create a deposit:

> For instance, when a bank receives a promissory note and holds it as security for an obligation to the bank, there is no deposit liability; however, if the bank purchases that promissory note and gives credit for the purchase price thereof, a liability is created which is a deposit. *Hearings on H.R. 8916 and H.R. 8928 before the Subcommittee of the House Committee on Banking and Currency*, 86th Cong., 2d Sess. (1960) at 26.

In other words, a promissory note does not create a deposit liability if it is merely a further evidence of the reimbursement obligation of the customer to the issuing bank set forth in the usual letter of credit between a bank and its customers.

Congress thus understood that the term "promissory note", as used in Regulation I, had been assigned a limited meaning. It was free to reject this meaning. Instead, it adopted the language of Regulation I without modification. As this Court has stated,

> Congress is presumed to be aware of an administrative or judicial interpretation and to adopt that interpretation when it re-enacts a statute without change....So too, where, as here, Congress adopts a new law incorporating sections of a prior law, Congress can normally be presumed to have had knowledge of the interpretation given to the incorporated law at least as it affects the new statute.

Lorrillard v. Pons, 434 U.S. 575, 580-81 (1978) (citations omitted); *see also Albemarle Paper Co. v. Moody*, 422 U.S. 405, 414 n.8 (1975); *NLRB v. Gullett Gin Co.*, 340 U.S. 361 (1951); *National Lead Co. v. U.S.*, 252 U.S. 140 (1920); 2A C. Sands, *Sutherland on Statutory Construction*, §49.09 (4th ed. 1973).

c. An unfunded standby letter of credit supported by a "contingent note" does not evidence receipt of money or its equivalent because the "contingent note" was not given "in exchange for" the issuance of the standby letter of credit.

The statute provides that a letter of credit will be regarded as evidencing the receipt of the equivalent of money when credited or issued *in exchange for* checks, drafts or promissory notes. 12 U.S.C. §1813(l)(1). The standby letter of credit in the present case was not issued "in exchange for" Orion's note. It is well-settled that a person on whose behalf a bank issues a standby letter of credit is obligated to reimburse the bank in the event that the letter of credit is drawn on. U.C.C. §5-114(3), U.C.P. §16(a). In this case, no agreement to the contrary appears to have varied this well-established rule.

When Orion requested Penn Square to issue a standby letter of credit, it was by law obligated to reimburse Penn Square should Penn Square be called upon to pay out on the letter of credit. The note did not create this obligation. It merely further evidenced the obligation. It does not appear that it was a necessary element in the transaction. It does not appear to have been separately bargained for and confers no rights beyond those accorded by operation of law. The letter of credit was not issued in exchange for the "contingent note" but rather for a fee and the legally established reimbursement obligation.

Neither funds nor their equivalent are entrusted to a bank when a customer merely provides a "contingent note" such as the one at issue here. This being the case, there can be no loss due to insolvency and thus no benefit in insuring against such a loss. If the Court of Appeals' holding is permitted to stand and the FDIC attempts to levy premiums on issuers of standby letters of credit of the sort in issue here, United States banks will run the risk of being required to pay very substantial amounts in unanticipated premiums, the FDIC may suddenly face a greatly increased potential insurance liability and users of standby letters of credit may be forced to pay higher fees all so that a nonexistent risk of loss may be insured. In addition there is a possibility

of such letters of credit becoming classified as deposits for other purposes such as reserve requirements. The result for CIB members and other banks may be exposure to millions of dollars of additional expense which would neither enhance the financial soundness of the banking industry nor provide additional protection for bank depositors.

II. The FDIC's interpretation of 12 U.S.C. §1813(l)(1) is entitled to the greatest deference.

The Court of Appeals also erred by using an improper standard of review of the FDIC's actions. In *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 5, this Court held that a federal agency's views must be given "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *See also Federal Election Commission v. Democratic Senatorial Campaign Commission*, 454 U.S. 27, 39 (1981); *Train v. National Resource Defense Council*, 421 U.S. 60, 75 (1975); *Zenith Radio Corp. v. U.S.*, 437 U.S. 443, 450 (1978); *Udall v. Tallman*, 380 U.S. 1 (1965); *Unemployment Compensation Comm'n v. Aragon*, 329 U.S. 143 (1946).

In the present case, the Court of Appeals rejected the FDIC's interpretation of the term "deposit". It approached the issue of the construction of the statute as if its role was *de novo* interpretation of the statute, as opposed to a determination of whether the FDIC's construction was sufficiently reasonable. As discussed earlier, the Court of Appeals' analysis of the term "deposit" was clearly incorrect. Yet even if the court had reasonable grounds to conclude that the note was a "deposit", the standard of review dictated by *Chevron* would require the court to defer to the FDIC's interpretation.

The FDIC's position in this action is identical to that which it articulated in 1935, the year that it promulgated its Regulation I pursuant to authority granted under the Banking Act of 1935, Ch. 614, 49 Stat. 684. Regulation I was the first detailed definition of the term "deposit". It provided that the term included

letters of credit when issued for "money or its equivalent" or for a charge against a deposit account and also provided that letters of credit would be regarded as representing the equivalent of money when issued in exchange for "checks or drafts or promissory notes upon which the person procuring...the [letter of credit] is primarily or secondarily liable." 12 C.F.R. §301.1 (1939 Edition) *quoted in Irving Trust Co.*, 137 F.Supp. at 148.

At the time it promulgated Regulation I, the FDIC specifically explained that certain letters of credit do not represent deposits under the regulation:

> If your letter of credit is issued by a charge against a depositor's account or for cash and the letter of credit is reflected on your books as a liability, you do have a deposit liability. If, on the other hand, you merely extend a line of credit to your customer, you will only show a contingent liability on your books. In that event no deposit liability has been created. *Transcript of Notes Taken at Special Meeting of the New York Bank Auditors and Comptrollers Conference, held on September 27 and 28, 1935 at 25-26 quoted in F.D.I.C. v. Irving Trust Co.*, 137 F. Supp. 145 (D.C.N.Y. 1955).

The FDIC has never altered its interpretation of the definition of a deposit. In *Irving Trust*, the FDIC repeated its position that letters of credit only represent deposits to the extent of the cash or its equivalent entrusted to the bank by the customer. As the courts have held, longstanding agency practice "should be given great weight because of the frequent consistency and longevity of its construction and the reliance placed thereon by the agency...." *Young v. Tennessee Valley Authority*, 606 F.2d 143 at 146 (6th Cir. 1979); see *Red Lion Broadcasting Co.*, 395 U.S. at 382.

The FDIC is the type of agency to which deference should presumptively be afforded because of the scope of its authority. *F.D.I.C. v. European American Bank Trust Co.*, 576 F. Supp. 950, 954 (S.D.N.Y. 1983). The Court in that case also found that deference was due the FDIC because of its expert knowledge of commercial banking.

This Court has also recognized that courts should par'icularly avoid disturbing an agency's decision where, as here, the parties subject to regulation by an agency have relied on longstanding administrative practice and would be harmed by the reversal. *Tallman*, 380 U.S. at 18. In structuring their letter of credit transactions, United States banks have relied on the FDIC's longstanding position that standby letters of credit secured by contingent notes do not represent deposits. If the Court of Appeals' decision is upheld, these banks may have to contend with the prospect of very substantial increases in insurance premiums or reserve levies or both. Moreover, the Court of Appeals' decision would enormously increase the potential insurance liability of the FDIC by bringing within the ambit of insurance protection over $100 billion in standby letters of credit. The cost of standby letters of credit would thus necessarily increase as banks passed along the cost of additional insurance premiums or reserve requirements to the customer seeking to open such credits.

Congress enacted into law the language of Regulation I when it amended the Federal Deposit Insurance Act. 74 Stat. 546 (1960). The FDIC testified in hearings prior to the adoption of the 1960 amendments. *Hearings on H.R. 8916 and H.R. 8928 before the Subcommittee of the House Committee on Banking and Currency*, 86th Cong., 2d Sess. (1960). This Court has repeatedly held that an agency's interpretation is entitled to great deference when the agency participated in drafting the statute in question. *Red Lion Broadcasting Co. v. F.C.C.*, (1979); *U.S. v. American Trucking Associations Inc.*, 310 U.S. 534, 549 (1940).

Congress has adopted the FDIC's language and thus its interpretation of the term. When it enacted the Federal Deposit Insurance Act of 1950, it did not alter the FDIC's long standing definition although it substantially altered the existing federal deposit insurance program in other ways. 64 Stat. 684.

III. The Court of Appeals' Interpretation of 12 U.S.C. §1813 (l)(1) conflicts with commercial reality and long-established understanding of the commercial world.

A ruling which treats a standby letter of credit secured by a "contingent note" as evidencing the receipt of "money or its equivalent" also disregards commercial reality, a fact recognized in other cases. In *In re F&T Contractors, Inc.*, 718 F.2d 171 (6th Cir. 1983), the United States Court of Appeals for the Sixth Circuit held that a standby letter of credit secured by a mortgage note was properly treated as a contingent liability and not a deposit liability.*

This recognition by the courts is consistent with the long and widely held view of the banking industry and the commercial world generally. The members of the banking community have never suggested that a letter of credit is a deposit. The members of the CIB are amazed at a court ruling which does so.

A deposit is universally understood to involve the receipt by a bank of money, securities or other property which or the equivalent of which the bank is obliged to return or for which it becomes indebted to the depositor.

In contrast, a letter of credit has been understood to be a commercial tool designed to facilitate commercial and financial transactions by effectuating payment among parties of very disparate interests and locations. The purposes of these payments cover the

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* Other cases have suggested that letters of credit generally represent contingent and not deposit liabilities. In *Sprague v. U.S.*, 627 F.2d 1044, 1049 n.8 (10th Cir. 1980), the court stated that a letter of credit is "not an evidence of indebtedness. It is merely a promise by a bank to lend money under certain circumstances." *See Sisalcords Do Brazil, Ltd. v. Fiacoio Brasileira De Sisal, S.A.*, 450 F.2d 419, 422-23 (5th Cir. 1971) *cert. den.* 406 U.S. 919 (1972). The drafters of the Uniform Commercial Code have also recognized this economic reality. In their official comments to U.C.C. §5-117 they noted that

> A bank which issues a letter of credit...engages its own credit. But the resulting liability is not like that to its depositors, and the security and indemnity furnished by the customer against it and the documents which it receives on honor of complying drafts are not like its own investments.

range from purchase of goods to securing performance or guarantying a payment or other obligation. A bank lends its credit and earns a fee. The letter of credit has been understood to serve this purpose since its development centuries ago.

To now treat the letter of credit as a deposit would be contrary to established concepts as to what a letter of credit is and what it is not. Even if the language of the Act might support such a construction of the term, this Court should be careful to avoid such a construction which so conflicts with the understanding of the entire banking community and the commercial world generally.

Respect for the purpose of the Act, the weight of judicial authority, commercial reality, the expertise of the FDIC, the consensus of numerous commentators, common understanding and centuries of commercial and financial practice require that the Court of Appeals' decision be reversed.

CONCLUSION

For the foregoing reasons, the Court should grant a writ of certiorari.

Respectfully submitted,

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APPENDIX A

12 U.S.C. §1813(l)(1)

§1813. Definitions

As used in this chapter-

(l) The term "deposit" means-

(1) the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank, or a letter of credit or a traveler's check on which the bank is primarily liable. *Provided*, That, without limiting the generality of the term "money or its equivalent", any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such bank for collection.

AMICUS CURIAE

BRIEF

No. 84-1972

Supreme Court, U.S.
FILED
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

v.

PHILADELPHIA GEAR CORPORATION,
Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE AMERICAN BANKERS ASSOCIATION, THE CALIFORNIA BANKERS CLEARING HOUSE ASSOCIATION AND THE NEW YORK CLEARING HOUSE ASSOCIATION AS *AMICI CURIAE*

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IN THE

Supreme Court of the United States

October Term, 1985

No. 84-1972

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Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE AMERICAN BANKERS ASSOCIATION, THE CALIFORNIA BANKERS CLEARING HOUSE ASSOCIATION AND THE NEW YORK CLEARING HOUSE ASSOCIATION AS *AMICI CURIAE*

This brief is in support of the position of the Federal Deposit Insurance Corporation (the "FDIC") and is filed pursuant to Rule 36.2 of the Rules of this Court with the consent of both parties.

Interest of *Amici Curiae*

The American Bankers Association ("ABA") is the largest national trade organization for the commercial banking industry in the United States. Its membership includes 12,000 banks, or more than 82% of the industry. ABA member banks are located in each of the 50 States and the District of Columbia, and all but a handful are members of the FDIC.

The New York Clearing House Association is an association of twelve leading commercial banks in the City of New York which clears commercial drafts and operates electronic transfer systems in the New York City area.[1] The California Bankers Clearing House Association is a similar association of eight major commercial banks in the State of California.[2] From time to time each of the three *amici* appears as *amicus curiae* before this Court and other appellate courts in cases that raise important questions of law relating to banking.

The court of appeals held that a bank letter of credit represented an insured deposit within the meaning of Section 1813(*l*)(1) of the Federal Deposit Insurance Act (the "Act"), 12 U.S.C. § 1811 *et seq.* (1984), even though the issuing bank received from its customer nothing more than a back-up "note" upon which nothing was due and no interest was to be assessed unless and until the letter of credit was actually drawn upon. *See Philadelphia Gear Corp.* v. *FDIC*, 751 F.2d 1131 (10th Cir. 1984). That decision represents a complete rejection of the FDIC's fifty years of consistent interpretation and administration of the Act and of equally longstanding commercial banking practice based on such administration.

The member banks of the three *amici* have outstanding billions of dollars of letters of credit, in connection with a

[1] The members of The New York Clearing House Association are The Bank of New York, The Chase Manhattan Bank, N.A., Citibank, N.A., Chemical Bank, Morgan Guaranty Trust Company of New York, Manufacturers Hanover Trust Company, Irving Trust Company, Bankers Trust Company, Marine Midland Bank, N.A., United States Trust Company of New York, National Westminster Bank USA, and European American Bank.

[2] The members of The California Bankers Clearing House Association include Bank of America National Trust and Savings Association, The Bank of California, N.A., Crocker National Bank, First Interstate Bank of California, Lloyds Bank California, Security Pacific National Bank, Union Bank, and Wells Fargo Bank, N.A.

material percentage of which the banks have received from their customers documentation similar to that received by the issuing bank here. These letters of credit were issued on the understanding that they were not deposits and thus not subject to assessment by the FDIC. Treating such letters of credit as deposits could require the member banks to pay millions of dollars in unprecedented and unanticipated deposit insurance premiums in the future.

Summary of Argument

The definition of deposit set forth in Section 1813(*l*)(1) of the Act provides that a letter of credit represents a deposit only when issued in exchange for "money or its equivalent," including, *inter alia*, a "promissory note." The letter of credit issued by Penn Square Bank, N.A. ("Penn Square") at the behest of its customer Orion Manufacturing Corp. ("Orion") for the benefit of Philadelphia Gear Corporation ("Philadelphia Gear") does not represent an insured deposit because the supposed "note" executed by Orion does not constitute money or its equivalent and is not a promissory note within the meaning of the Act. The purpose of federal deposit insurance is to protect those who entrust money to insured banks. Clearly, a letter of credit issued upon a mere contractual obligation of the bank's customer to reimburse the bank for such sums as the bank may disburse does not represent a deposit within the meaning of the Act because no money has been given to the bank in exchange. This result is not altered because the bank's customer executes a document entitled "promissory note" which does not represent any existing debt to the bank but merely an obligation to reimburse the bank that might arise in the future.

The protection of federal deposit insurance cannot depend upon the label private parties attach to such a docu-

ment. A person executing a "note" with the explicit understanding that nothing was due and no interest would accrue on the "note" unless and until the letter of credit was drawn upon does not entrust money or its equivalent in any real economic sense to the bank. He does not run the risk of loss of his own funds should the bank suspend its operations before payments are made on the letter of credit. To say that such a document gives rise to an insured deposit is to ignore reality and the intent of Congress to insure funds deposited with a bank by its customer, not inchoate contractual obligations of the customer to the bank.

The FDIC, with its long experience in administering the federal deposit insurance system, has given effect to the statutory purpose by consistently holding that deposit insurance is not available for unfunded letters of credit issued upon execution of "back-up" notes. The FDIC itself drafted the statutory language at issue here, which first appeared in Regulation I promulgated by the FDIC in 1935. The FDIC's regulatory treatment was adopted by Congress when it incorporated the language of Regulation I into the statute in 1960. The FDIC's consistent application of both the regulation and the statute has been relied upon by insured banks and others for over fifty years. This Court should therefore accept the FDIC's position as a reasonable interpretation of the Act and reverse the decision below.

ARGUMENT

I.

The FDIC's Determination That an Unfunded Letter of Credit Does Not Represent an Insured Deposit Is Entitled to Deference.

In rejecting the FDIC's determination that the letter of credit at issue is not a deposit, the court of appeals failed to give the FDIC's interpretation of the Act the deference

to which it is entitled. For over fifty years, the FDIC has been called upon to interpret the definition of deposit in collecting deposit assessments and paying deposit insurance. Given its experience with commercial banking and the statutory scheme, the FDIC is "precisely the type of agency to which deference should presumptively be afforded." *Federal Election Commission* v. *Democratic Senatorial Campaign Committee*, 454 U.S. 27, 37 (1981); *see also Chemical Manufacturers Association* v. *Natural Resources Defense Council*, 105 S. Ct. 1102 (1985); *Securities Industry Association* v. *Board of Governors*, 104 S. Ct. 3003 (1984); *Jones* v. *FDIC*, 748 F.2d 1400 (10th Cir. 1984); *FDIC* v. *Sumner Financial Corp.*, 451 F.2d 898, 902 (5th Cir. 1971); *FDIC* v. *European American Bank & Trust Co.*, 576 F. Supp. 950, 954 (S.D.N.Y. 1983).

In the present circumstances where there are certainly no "compelling indications that it is wrong," the FDIC's construction "should be followed" by the courts. *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 381 (1969) (footnote omitted).

A. The FDIC Is Qualified to Interpret the Definition of Deposit It Drafted and Administered for Fifty Years.

As originally enacted in 1935, the Act provided that a deposit was created only if a bank received "money or its equivalent," but neither defined this term nor made any mention of letters of credit or promissory notes. Banking Act of 1935, 49 Stat. 684. The Act, however, explicitly authorized the FDIC to supplement the statutory definition. *Id.*, at 385-86. Exercising this authority (*see FDIC* v. *Irving Trust Company*, 137 F. Supp. 145, 147 (S.D.N.Y. 1955)),[3] that same year the FDIC provided in Regulation I

[3] The FDIC, in conjunction with the Comptroller of the Currency and the Federal Reserve Board, continues to have such authority. 12 U.S.C. § 1813(*l*)(5).

that a letter of credit could represent a deposit, but only when issued for "money or its equivalent received by the issuing bank" or for a charge against a deposit account and further provided that such an instrument is deemed to have been issued for "money or its equivalent" when issued for "promissory notes upon which the person procuring . . . [the letter of credit] is primarily or secondarily liable." *See* 12 C.F.R. § 301.1 (1939 ed.), *quoted in Irving Trust*, 137 F. Supp. at 147-48.

From the outset the FDIC interpreted Regulation I to exclude from insured deposits unfunded letters of credit such as that at issue here. In a meeting in 1935 to explain the new statute and regulation to New York bankers, an official of the FDIC stated that a letter of credit could represent a deposit for deposit insurance purposes when "issued by a charge against a depositor's account or for cash" but not when the bank "merely extend[s] a line of credit to [its] customer" and "show[s] a contingent liability on [its] books." *Transcript of Notes Taken at Special Meeting of NY Bank Comptrollers and Auditors Conference Held September 27 and 28, 1935 ("1935 Transcript") at* 25-26, *quoted in Irving Trust*, 137 F. Supp. at 161.[4] This view of what constitutes an insured deposit, consistently maintained, "has peculiar weight [because] it involves a contemporaneous construction of a statute by the [persons] charged with the responsibility of setting its machinery in motion. . . ." *Zenith Radio Corp.* v. *United States*, 437 U.S. 443, 450 (1978), *quoting Norwegian Nitrogen Products Co.* v. *United States*, 288 U.S. 294, 315 (1933); *accord Udall* v. *Tallman*, 380 U.S. 1, 16 (1965); *Miller* v. *Youakim*, 440 U.S. 125, 144 (1979); *see Ford Motor Credit Co.* v. *Milhollin*, 444 U.S. 555, 566 (1980) (agency interpretation of its own regulation).

[4] The transcript of the questions and answers at the meeting was edited by an official of the FDIC and (as noted on the cover sheet of the transcript) "amended to give effect to [its] most recent decisions and rulings." *See 1935 Transcript; Irving Trust*, 137 F. Supp. at 161. The view of letters of credit expressed therein has not been contradicted by any later official statement and is both the original "legislative history" of the statutory language and clear evidence of the longevity and consistency of the FDIC's position in this litigation.

The validity of the FDIC's position is further underlined by the fact that "Congress has refused to alter the administrative construction" despite several opportunities to modify the FDIC's treatment of letters of credit over the past fifty years. *Red Lion Broadcasting Co.*, 395 U.S. at 381; *NLRB* v. *Hendricks County Rural Electric Membership Corp.*, 454 U.S. 170, 177 (1981). In 1950, Congress undertook a comprehensive revision of the federal deposit insurance statute but left Regulation I untouched. *See* Federal Deposit Insurance Act of 1950, Pub. L. 81-797, 64 Stat. 873; *Irving Trust*, 137 F. Supp. at 148. More importantly, in 1960 Congress incorporated the relevant language of Regulation I virtually verbatim into the statutory definition of deposit. *See* Pub. L. 86-671, 74 Stat. 546 (1960).

The legislative history indicates that the 1960 amendments were meant to adopt the existing administrative practice, not to change the FDIC's interpretation. The stated purpose of the amendments was nothing more than to "simplify the process of determining the assessments paid by banks insured by the Federal Deposit Insurance Corporation." S. Rep. No. 1821, 86th Cong., 2d Sess. 1 (1960) *reprinted in* 1960 U.S. Code Cong. & Ad. News 3234. The proposed changes restated the definition of deposit "to include items which have been prescribed by regulations of the Corporation to be deposits." *Hearing on H.R. 12465 Before the Senate Committee on Banking and Currency*, 86th Cong., 2d Sess. 50 (1960) (Supplementary Statement of William G. Loeffler).

By 1960 the FDIC's view that letters of credit represented insured deposits only to the extent of cash or its equivalent entrusted to the bank by the customer was of twenty-five years standing.[5] That view was judicially approved in *Irving Trust* after extensive consideration of the legislative and administrative history, including the *1935 Transcript*. *See* 137 F. Supp. at 161-63.[6] In these circumstances, the conclusion is inescapable that Congress meant to adopt the FDIC's interpretation of Regulation I along with its language. "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation" both when it "re-enacts a statute without change" and when it "adopts a new law incorporating sections of a prior law . . . . " *Lorillard* v. *Pons*, 434 U.S. 575, 580-81 (1978) (citations omitted); *see also Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Curran*, 456 U.S. 353, 381-82 (1982).

In this case, the presumption is a virtual certainty because the decision in *Irving Trust* approving the FDIC's position on deposits under Regulation I, including its treatment of letters of credit, was explicitly referred to in the hearings on the 1960 amendments. *Hearings on H.R. 8916 and H.R. 8928 Before the Subcommittee of the House Committee on Banking and Currency*, 86th Cong., 2d Sess. 112-13 (1960)

[5] A contemporaneous construction, consistently maintained for so many years, is especially entitled to deference (*see, e.g., Zenith Radio Corp.* v. *United States*, 437 U.S. at 450), as opposed to later reinterpretations of a statute by an agency which are subject to stricter scrutiny, particularly where the agency departs from existing practice. *See BankAmerica Corp.* v. *United States*, 462 U.S. 122, 130 (1983); *North Haven Board of Education* v. *Bell*, 456 U.S. 512, 538 n.29 (1982).

[6] *Irving Trust's* exhaustive analysis of the treatment of letters of credit for purposes of federal deposit insurance was apparently not considered by the court of appeals in this case.

(Statement of Royal L. Coburn).[7] Where the existing agency interpretation is actually brought to Congress's attention and not altered, "presumably the legislative intent has been correctly discerned" by the agency. *United States* v. *Rutherford*, 442 U.S. 544, 554 n.10 (1979); 2A Sands, SUTHERLAND ON STATUTORY CONSTRUCTION § 49.09 (4th ed. 1984).

B. The FDIC's Longstanding Position Has Been Relied Upon by Insured Banks and Others.

The FDIC's consistent treatment of unfunded letters of credit should be accepted for the additional reason that the parties subject to regulation by the FDIC have relied on its practice for over fifty years and would be harmed by a reversal. *BankAmerica Corp.* v. *United States*, 462 U.S. at 132-33; *Zenith Radio Corp.* v. *United States*, 437 U.S. at 457-58; *Udall* v. *Tallman*, 380 U.S. at 18. The practical consequences rejection of the FDIC's position would have for insured banks and others were not adverted to by the court of appeals.

The FDIC has never required, and the member banks of the three *amici* and numerous other commercial banks throughout the country have never paid, any deposit insurance premiums on unfunded letters of credit such as that at issue here because the FDIC has never defined them as deposits in determining the assessment base. Not until this litigation has that consistent practice been challenged. Adopting Philadelphia Gear's novel interpretation of the statute would enormously increase the potential insurance liabilities of the FDIC and could require insured banks to pay substantial additional premiums in the future.

[7] These bills were superseded by H.R. 12465, which was ultimately enacted into law. The material portions of the proposed amendments to the definition of deposit were identical.

Moreover, because the FDIC's view that unfunded letters of credit do not represent insured deposits has been relied upon in recent amendments to the federal tax laws, any change could have serious adverse consequences in other areas. Certain municipal bonds, which are primarily marketed as bearing interest that is exempt from federal income tax, are frequently supported by letters of credit issued by banks. In the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494, Congress amended the Internal Revenue Code to deny such bonds the otherwise available tax exemption if they are directly or indirectly guaranteed by the federal government, but provided that such bonds are not deemed to be federally guaranteed merely because "there is a guarantee by a financial institution." 26 U.S.C. 103(h)(1), (3)(D). The legislative history of the exception for financial institution guarantees indicates that it was intended to include letters of credit, apparently on the assumption that federal deposit insurance did not cover such obligations. *See* Staff of the Joint Committee on Taxation, *General Explanation of the Revenue Enhancement Provisions of the Deficit Reduction Act of 1984* at 941 (December 31, 1984) (no federal guarantee where there is a financial institution guarantee "other than by means of Federal deposit insurance (*e.g.* by a letter of credit)"); H. Rep. No. 432, 98th Cong., 2d Sess. at 1960 (March 5, 1984).

Tax experts have expressed concern that the decision below means that such bonds supported by letters of credit are indirectly guaranteed by the federal government through federal deposit insurance and therefore are not tax-exempt, and the uncertainty thereby created has disrupted the extremely sensitive market for these bonds. The Internal Revenue Service has recognized that the decision below has "raised concerns regarding the tax-exempt status of

obligations guaranteed by letters of credit," *News Release IR-85-32* (April 1, 1985). It has put its resolution of the status of such bonds on hold pending this Court's decision in this case by announcing that, under a "grandfather" provision, it will allow such bonds tax-exempt status if issued no later than 120 days after such decision. *News Release IR-85-113* (Nov. 27, 1985). Thus, the confusion in the bond market arising from the questionable status of letters of credit continues.[8]

In addition, the court of appeals' decision could have the anomalous effect of denying tax-exempt status to bonds backed by letters of credit issued by domestic banks, which are insured, but allowing the exemption when the letters of credit are issued by foreign banks, which are not federally insured. Such disparate treatment would be contrary to "the principle of parity of treatment between foreign and domestic banks in like circumstances" established by Congress in enacting the International Banking Act of 1978, 12 U.S.C. § 3101 *et seq.*, S. Rep. No. 1073, 95th Cong., 2d Sess. 2 (1978), *reprinted in* 1978 U.S. Code Cong. & Ad. News 1421, 1422.

Reversal of the decision below is necessary to enable domestic banks to continue to assist state and local governments in obtaining the best financial terms for the bonds they issue, as Congress intended.

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[8] Although this problem theoretically could be avoided if the issuing bank does not take a back-up "promissory note" from the bank's customer, because absolute certainty as to the federal tax exemption is necessary to the marketability of municipal bonds, the uncertainty created by the decision below has a chilling effect on the market for all such bonds supported by letters of credit.

II.

Orion's "Note" Is Not a Promissory Note Within the Meaning of the Federal Deposit Insurance Act.

The ultimate question in this case is whether the document executed by Orion in connection with the issuance of the letter of credit is a promissory note constituting money or its equivalent within the meaning of Section 1813(*l*)(1). The court of appeals answered that question erroneously because, in attaching too much importance to the label "promissory note," it lost sight of both economic reality and the purpose of federal deposit insurance.

There is no question but that a letter of credit issued "in exchange for" a customer's mere contractual undertaking to repay the bank if it should disburse funds on the customer's behalf, does not represent an insured deposit. Indeed, under the Uniform Commercial Code, the bank is automatically entitled to such reimbursement for payment under a letter of credit, U.S.C. § 5-114(3).[9] By attaching the label "promissory note" to part of the documentation of that obligation, private parties cannot transform it into money or its equivalent or the letter of credit into an insured deposit.

Orion executed a "note" on which "[b]oth Orion and Penn Square understood that nothing would be considered due . . . nor would interest be charged unless and until"

[9] Given the statutory obligation to reimburse, it is questionable whether a letter of credit is issued "in exchange for" documentation reflecting (but in no way adding to) that obligation, whatever its form. Put another way, Congress's use of "in exchange for" makes sense only when the bank's customer parts with something of present value, *i.e.*, "money or its equivalent." For the same reason, such a note does not satisfy the requirement that a deposit be an "unpaid balance." *See* Section 1813(*l*)(1).

Philadelphia Gear actually drew against the letter of credit, which it had not done by the time Penn Square was declared insolvent. 751 F.2d at 1134. This so-called "note" thus did not represent a legally effective and enforceable obligation to the bank when delivered, but only part of the documentation of its customer's legal obligation to pay a debt that might arise in the future. Such a document, the negotiation or assignment for value of which would have been fraudulent, is not a promissory note as that term is generally understood and used by Congress or anyone else.

The FDIC's determination that such a "note" is not the equivalent of money, and therefore that the letter of credit is not an insured deposit, is also the only reading of the statute consistent with the purpose of federal deposit insurance. The federal deposit insurance system was created to protect those who entrust money to an insured bank against loss because of bank failure. S. Rep. No. 1821, 86th Cong., 2d Sess. 1, *reprinted in* 1960 U.S. Code Cong. & Ad. News 3234. Thus, a letter of credit represents an insured deposit only when in exchange for the letter the bank's customer delivers to the bank something of value equivalent to money.

> "In the context of federal deposit insurance, this would seem to be the only rational and relevant test; because the customer who delivers his own funds to the bank risks their total or partial loss if the bank should suspend operations before they are paid out to the beneficiary or returned to the customer."

Irving Trust, 137 F. Supp. at 162.

In this case, it is undisputed that neither the bank's customer nor the beneficiary entrusted to the bank anything of a value equivalent to money in return for the

issuance of the letter of credit. Orion ran no risk of loss if the bank were to suspend operations, nor, if the letter of credit terminated without being drawn upon, would any funds be returned or credited to it. Thus, as the bank's customer, Orion would not be entitled to deposit insurance because it entrusted no funds to the bank. *A fortiori,* to allow Philadelphia Gear as beneficiary of the letter of credit to collect deposit insurance would be to award it a windfall payment inconsistent with the purpose of the Act.[10]

That Orion's "note" is not "money or its equivalent" within the meaning of the Act is also clear from the language of the statute itself.[11] Along with promissory notes, Section 1813(*l*)(1) provides that a letter of credit is deemed to have been issued for money or its equivalent where issued "for checks or drafts . . . . or for a charge against a deposit account, or in settlement of checks, drafts or other instruments forwarded to such bank for collection." It is clear from the nature of these other instruments that before a deposit liability arises, there must be delivered to the bank some unconditional obligation of certain value in respect of which the bank can obtain value at the time it is

[10] This case does not involve a challenge to Philalelphia Gear's status as a general creditor of Penn Square. Rather the question is whether Philadelphia Gear is entitled to the preferred status of an insured depositor even though the bank received nothing of value.

[11] Even if the "note" at issue fell within the broadest possible reading of Section 1813(*l*)(1), this Court should not find the letter of credit to represent an insured deposit. Any other result would be inconsistent with the purpose of federal deposit insurance, upon which the FDIC's longstanding regulatory treatment of letters of credit is premised. A statute should not be so literally read as to frustrate the legislative purpose. *See Chemical Manufacturers Association* v. *Natural Resources Defense Counsel,* 105 S. Ct. at 1108; *NLRB* v. *Hendricks County Rural Electric Corp.,* 454 U.S. at 177; *Watt* v. *Alaska,* 451 U.S. 259, 266 (1981); 2A Sands, SUTHERLAND ON STATUTORY CONSTRUCTION § 46.07 (4th ed. 1984).

delivered. Since each other term in the group identified as "money or its equivalent" refers to an instrument that represents real and immediate value, the term "promissory note" should be interpreted to reach a similar result. *Securities Industry Association* v. *Board of Governors,* 104 S. Ct. at 3010. It is not the nominal status of a document that qualifies it as a "promissory note," but rather whether the document evidences a certain and existing indebtedness to the bank.

Because the issue is whether any funds or their equivalent were deposited with the bank, the court of appeals' focus on whether the "note" was on its face negotiable for purposes of the Uniform Commercial Code is beside the point. Its additional concern that issuance of the letter of credit "set in motion other commercial activity in reliance thereon . . . ", 751 F.2d 1135, is similarly irrelevant, since it is not the purpose of deposit insurance to make the federal government the guarantor of private business transactions. Moreover, there is not the slightest indication that beneficiaries of unfunded letters of credit have ever relied on the credit of the FDIC as opposed to that of the issuing banks, and they could not reasonably have done so in light of the FDIC's consistent position that such instruments were not covered by deposit insurance.

As indicated by the history of the definition of deposit found in Section 1813(*l*)(1), promissory notes were included in the explanation of "money or its equivalent" to make clear that when a loan customer receives in exchange for a note, not delivery of cash, but rather a credit to his account or a bank instrument representing an immediate liability (such as a certificate of deposit, cashier's check or traveler's check), the funds so advanced become insured deposits.

> "A man who is not a depositor comes in and borrows half a million dollars and is given a cashier's check for that amount. The cashier's check was issued for money or its equivalent. That is the same situation as if you loaned me half a million dollars and set up an ordinary account against which I would draw."

1935 Transcript at 15-16. Thus, the effect is to treat the performance of lending and depository functions by a single bank no differently than if two banks had been involved, one making a loan and the other crediting a deposit account or issuing a cashier's check from the proceeds of that loan.

This analysis leads to a different conclusion where the bank issues a letter of credit due to a critical practical difference between letters of credit and other bank instruments, such as certificates of deposit, cashier's checks and traveler's checks. In order to obtain one of the latter instruments, the bank's customer must immediately fund the instrument by delivering to the bank something of value equivalent to money. This is necessary because a bank assumes an immediate and direct liability to make payment of certain value on such instruments. If the customer lacks the necessary funds he must borrow them from the issuing bank or another source.

In contrast, any letter of credit is "merely a promise by a bank to lend money under certain circumstances" by making a payment to the beneficiary on the customer's behalf. *Sprague* v. *United States*, 627 F.2d 1044, 1049 n.8 (10th Cir. 1980). A bank "properly treat[s] its obligation under each letter as a contingent liability and the [assets] supporting them as contingent assets." *In re F&T Contractors, Inc.*, 718 F.2d 171, 181 (6th Cir. 1983); *see Sisalcords Do Brazil, Ltd.* v. *Fiacao Brasileira De Sisal, S.A.*, 450 F.2d 419, 422-23 (5th Cir. 1971), *cert. denied*,

406 U.S. 919 (1972).[12] To obtain a letter of credit, the customer may not be required immediately to fund the letter of credit by depositing something of value, but, at the bank's discretion, may simply undertake to deliver funds to the bank in the future if and when the bank is called upon to make advances on the letter of credit.[13]

Thus, in issuing letters of credit a bank undertakes to function as a lender at some point in the future, if at all. The bank does not function as a depository at all unless, as in *Irving Trust*, cash or its equivalent is actually received from the bank's customer. This is the basis for the FDIC's consistent position that unless funds are actually received in return, in issuing a letter of credit the bank "merely extend[s] a line of credit to [its] customer" and no deposit is created. *1935 Transcript* at 25, *quoted in Irving Trust*, 137 F. Supp. at 161. Even if some funds are actually

[12] The drafters of the U.C.C. have explicitly recognized that a letter of credit is properly treated as a contingent liability which is "not like that to [the bank's] depositors, and the security and indemnity furnished by the customer against it and the documents which it receives on honor of complying drafts are not like its own investments." Official Comment to U.C.C. § 5-117.

[13] The FDIC has in other circumstances distinguished between loans and commitments to lend and, in connection with the latter, has deemed contingent "notes" like that executed by Orion not to be "money or its equivalent." In two assessment decisions the FDIC explicitly determined that "notes" on which "the customer is liable only for amounts as and when they are actually advanced from time to time" and "interest is paid by the borrower on only such amounts thereof as are actually advanced" do not give rise to insured deposits. FDIC Assessment Decision No. 45, *Commitments for Loans* (April 1955), 12 C.F.R. § 327.145 (1956); *see also* Assessment Decision No. 48, *Construction Loans* (June 1956), 12 C.F.R. § 327.148 (1956). These assessment decisions were ultimately withdrawn when statutory amendments rendered them unnecessary, but nonetheless indicate that the position advanced by the FDIC in this litigation is in keeping with the purpose of the statute and has been consistently maintained for decades.

delivered to the bank but are less than the face amount of the letter of credit issued, "the amount of the 'cash collateral' should be shown as a deposit liability and the remainder of the amount of the letter should be shown as a contingent liability." *Irving Trust*, 137 F. Supp. at 163.[14] Thus, in the case of a letter of credit, the critical factor in the creation of a deposit is funding, and only if and to the extent funding occurs does a deposit liability exist.

Only a note representing an existing and immediate obligation to the bank and bearing interest from the date of issuance can be said to be the equivalent of cash. The "note" at issue here is simply not money or its equivalent in any real economic sense and therefore not a "promissory note" within the meaning of the Federal Deposit Insurance Act. To hold that such a document gives rise to an insured deposit is contrary to the intention of the Act, to the FDIC's consistent interpretation and to common sense.

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[14] The Federal Reserve Board has drawn a similar distinction between deposit and contingent liabilities, which is persuasive evidence that the FDIC's position is correct. *See FDIC* v. *Continental Illinois National Bank & Trust Co.*, 245 F.2d 567, 571 (7th Cir.), *cert. denied*, 355 U.S. 877 (1957). In defining deposits for reserve requirement purposes, the Board substantially adopted the wording of Section 1813(*l*)(1) and further provided that the term deposit "does not include [a]n obligation that represents a conditional, contingent or endorser's liability . . . ." 12 C.F.R. § 204.2(a)(2)(ii) (1985).

Conclusion

For the reasons stated herein, the judgment below should be reversed.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

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Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION,

Petitioner

v.

PHILADELPHIA GEAR CORPORATION,

Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF *AMICUS CURIAE* OF THE COUNCIL ON INTERNATIONAL BANKING, INC. IN SUPPORT OF REVERSAL

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QUESTION PRESENTED

Does an unfunded standby letter of credit supported by a "contingent note" represent a "deposit" as defined in 12 U.S.C. §1813(l)(1)?

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No. 84-1972

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION,

Petitioner

v.

PHILADELPHIA GEAR CORPORATION,

Respondent

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF *AMICUS CURIAE* OF THE COUNCIL ON INTERNATIONAL BANKING, INC. IN SUPPORT OF REVERSAL

The Council on International Banking, Inc. ("CIB") hereby submits its brief *amicus curiae* in support of the reversal of a judgment of the United States Court of Appeals for the Tenth Circuit entered on December 27, 1984, upholding a decision by the United States District Court for the Western District of Oklahoma that an unfunded standby letter of credit supported by a "contingent note" represents a "deposit" under the Federal Deposit Insurance Act (the "Act").

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Tenth Circuit is reported in 751 F.2d 1131. The opinion of the U.S. District Court for the Western District of Oklahoma is reported in 587 F.Supp. 294.

JURISDICTION

This Court has jurisdiction to review the decision of the United States Court of Appeals for the Tenth Circuit under 28 U.S.C. §1254(1) because the United States Court of Appeals for the Tenth Circuit has decided an important question of federal law involving the construction of the term "deposit" under the Federal Deposit Insurance Act which has not been, but should be, settled by this Court. Judgment was entered on December 27, 1984. A petition for rehearing, timely filed by the FDIC, was denied on February 19, 1985. On May 10, 1985, Justice White extended the time within which to file a petition for a writ of certiorari to June 19, 1985. The Federal Deposit Insurance Corporation ("FDIC") timely filed a petition for a writ of certiorari on June 19, 1985. This Court filed an order allowing certiorari on October 21, 1985.

PARTIES TO THE PROCEEDING BELOW

All of the parties appearing before the United States Court of Appeals for the Tenth Circuit are listed in the caption.

STATUTORY PROVISIONS INVOLVED

This case calls upon the Court to construe the meaning of the term "deposit" as it is defined under the Federal Deposit Insurance Act in 12 U.S.C. §1813(l)(1).

The text of §1813(l)(1) is set out in Appendix A.

INTEREST OF COUNCIL ON INTERNATIONAL BANKING

The Council on International Banking, Inc. ("CIB") is a not-for-profit corporation, organized under the New York Not-For-Profit-Corporation Law, which is dedicated to the promotion and development of sound and efficient international banking operations. It and its predecessors have been in continuous existence since 1924. Its membership consists of over 335 money center,

regional and community banks located in New York City and throughout the eastern United States. The membership includes virtually all of the banks in the eastern United States which conduct significant international operations. It members have issued billions of dollars of standby letters of credit, some of which are backed by promissory notes of the kind at issue here. It has affiliated organizations in the mid and far west and is the only organization of its kind.

The CIB actively seeks development, recognition and acceptance of uniform procedures, formats, forms, automated systems and the settlement of mutual problems. It seeks also further to educate its members on the operational and technical problems in international banking and to solve these problems. It sponsors seminars, publishes guides and responds to specific inquiries involving bank operations. The representatives of its members are responsible for the day to day conduct of their banks' operations.

The CIB has long taken an active interest in the subject of letters of credit. Its separate committee on letters of credit, composed of experienced bankers prominent in their field, meets at least monthly to review developments in the field and to recommend industry-wide solutions to particular problems. These solutions often become the industry standard.

Given the minimum documentation, inherent time pressures, and large dollar amounts at stake, the letter of credit requires a uniform understanding by all who utilize it. The definition of what a letter of credit is, how it operates and the consequences of issuing one are of paramount interest and concern to the CIB and its members.

The sole issue addressed by the CIB in this brief is whether standby letters of credit represent deposits as defined in 12 U.S.C. §1813(l)(l) when the issuing bank's customer (the account party) gives the bank a "contingent note" with the understanding that nothing will be considered due on the note unless and until the letters of credit are actually drawn upon. The United States Court of Appeals for the Tenth Circuit held that such a letter of credit does represent a deposit for the purpose of 12 U.S.C. §1813(l)(1).

The FDIC may assess banks deposit insurance premiums for their standby letters of credit supported by "contingent notes" unless the lower Court decision is overturned. In addition there is a possibility of such letters of credit becoming classified as deposits for other purposes such as reserve requirements. The result for CIB members and other banks may be exposure to millions of dollars of additional expense which would neither enhance the financial soundness of the banking industry nor provide additional protection for bank depositors.

STATEMENT OF THE CASE

Respondent in this case is the beneficiary of an irrevocable standby letter of credit issued on April 23, 1981 by Penn Square Bank, N.A. ("Penn Square") upon the application of Orion Manufacturing Corporation ("Orion"), a customer of the respondent. Penn Square issued the letter of credit without the deposit of any funds by Orion. All that Penn Square obtained was an unsecured, "contingent note" which matured on the day the letter of credit expired. No interest was to be charged and nothing was to be due on this note prior to presentation of the documents required under the letter of credit. The understanding between the parties was that Penn Square would have no claim against Orion unless and until the bank was called upon to make an advance under the letter of credit. Thus, no actual indebtedness existed at the time the "contingent note" was delivered.

On July 5, 1982, the Comptroller of the Currency declared Penn Square insolvent and respondent thereafter sought payment under the letter of credit. The FDIC, in its capacity as receiver, stated that it had no obligation under the letter of credit. The respondent then sued the FDIC in its capacity as insurer for deposit insurance proceeds, claiming that the letter of credit represented a deposit as the term is defined in 12 U.S.C. §1813(1)(1) of the Federal Deposit Insurance Act.*

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* The respondent also sued the FDIC in its capacity as receiver for the alleged total uninsured outstanding balance of the letter of credit. That claim is not the subject of the FDIC's brief.

The United States District Court for the Western District of Oklahoma held that the letter of credit did represent a deposit. *Philadelphia Gear Corporation v. F.D.I.C.*, 587 F. Supp. 294 (W.D. Okla. 1984). The FDIC appealed to the Tenth Circuit Court of Appeals which affirmed the District Court's holding. The FDIC filed a petition for a writ of certiorari to this Court which granted the petition.

The case turns upon the meaning of the term "deposit" in 12 U.S.C. §1813(1)(1).

SUMMARY OF ARGUMENT

The Act clearly envisions that standby letters of credit do not represent "deposits" because only those letters of credit upon which a bank is "primarily liable" are included within the scope of the term. Despite the fact that it is well-established that standby letters of credit are, in substantial respects, functionally equivalent to guaranty contracts and create only contingent bank liabilities, the Court of Appeals in effect concluded that all letters of credit create a primary liability for purposes of the Act. In so doing, the court ignored the nature of standby letters of credit and disregarded the Act's use of the qualifying term "primarily liable."

The receipt of the note at issue in this case is not a deposit as the term is defined under the Act because it represents nothing more than additional evidence of a conditional promise to Penn Square and not a present indebtedness. No thing of value was entrusted to Penn Square and thus no thing of value was lost when Penn Square became insolvent. Since the purpose of the Act is to prevent the loss of entrusted funds due to bank insolvency, the payment of insurance proceeds by the FDIC in this case would conflict with the basic purpose of the Act. It would in fact create a windfall for a recipient who has sustained no loss due to bank insolvency and might force banks to pay insurance for "deposits" which were in reality never made.

Moreover, the statute's provision that a letter of credit represents a deposit when issued "in exchange for" a promissory note is further indication that the transaction involved here did not involve a deposit. No such exchange occurred in this case. Rather, the

note merely further evidenced a contingent obligation of Orion to Penn Square which arose by operation of law. The note itself did not create this obligation. It conferred no additional rights upon Penn Square. In fact, the letter of credit was issued in exchange not for a "contingent note" but presumably for a fee together with the established legal obligation of Orion to reimburse Penn Square which would arise when the letter of credit was drawn upon.

The FDIC drafted the language defining the term "deposit" in the Act as well as substantial portions of the balance of the Act. Given this fact, its substantial experience with the administration of the Act, and its intimate knowledge of commercial banking, the FDIC's interpretation of the term is entitled to great deference.

The FDIC has, for fifty years, consistently interpreted the term "deposit" to exclude letters of credit which are not secured by evidence of present indebtedness. Congress was aware of this interpretation when it enacted the FDIC's language in 1960 and should therefore be presumed to have adopted the FDIC's interpretation of the term. In addition, insured banks have relied heavily upon the FDIC's consistent interpretation of the statute.

Not only has the FDIC held to this view but the commercial world has never regarded the letter of credit as more than a commercial tool to effectuate payments. This has been the function of the letter of credit for centuries. To now construe it as giving rise to a deposit even if the statutory language would support such a reading is contrary to long and widely held understanding of what a letter of credit is and is not.

ARGUMENT

I. An unfunded standby letter of credit supported by a "contingent note" does not represent a "deposit" as defined in 12 U.S.C. §1813(l)(l).

a. A standby letter of credit is not a primary bank liability.

A "deposit" is defined under the Act to include "the unpaid balance of money or its equivalent...evidenced by...a letter of credit...on which the bank is primarily liable...." 12 U.S.C. §1813(l)(1). The Court of Appeals' holding that the bank was "primarily liable" on the standby letter of credit disregards the specific intent of §1813(l)(1). The definition of the term "deposit" in that section contemplates that there exist certain letters of credit upon which a bank is only secondarily liable. If all letters of credit were intended to be included, no such qualifying language would be necessary.

A standby letter of credit is a secondary — not a primary — bank liability. While the bank becomes primarily liable once the contingency which the standby letter of credit was issued to cover occurs, the letter of credit itself and thus the issuing bank's obligation thereunder is secondary or contingent to the obligation of the obligor in the underlying transaction. The bank's function with respect to a standby letter of credit is to act as a surety for its customer's failure to pay the primary obligation. "The bank is, in essence, secondarily liable, a conceptual distinction that separates the [standby] letter of credit from the traditional letters of credit and might justify the application of different rules of law." Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan. L. Rev. 716 (1973).

Unlike other letters of credit, the standby letter of credit is, as the Court of Appeals acknowledged, similar in many respects to a surety's contract to guaranty a principal's debt. A recent decision by the United States Court of Appeals for the Fifth Circuit recognized this fact by holding that a standby letter of credit is a contingent and not a primary deposit liability. *In Re F & T*

Contractors, Inc., 718 F.2d 171 (6th Cir. 1983). Numerous commentators have also recognized that standby letters of credit are, in substantial respects, functionally equivalent to guaranty contracts. Verkuil, *Bank Solvency and Guaranty Letters of Credit*, 25 Stan.L.Rev. 716 (1973); Lord, *The No-Guaranty Rule and the Standby Letter of Credit Controversy*, 96 B.L.J. 46 (1979); Harfield, *The Standby Letter of Credit Debate*, 94 B.L.J. 293 (1977); Campbell, *Guaranties and the Suretyship Phases of Letters of Credit*, (Pts. 1-2), 85 U.Pa.L.Rev. 175, 261 (1936-1937).

This functional similarity between standby letters of credit and guarantees has been recognized and codified by the Comptroller of the Currency in regulations imposing lending limitations on national banks. 12 C.F.R. §32.2(d). That provision specifically includes within the definition of loans and extensions of credit "an obligation to guarantee or stand as surety for the benefit of a third party. The term includes...standby letters of credit... guarantees...and other similar arrangements.... The definition does not include commercial letters of credit and similar instruments...."

As more fully discussed below in section II, the FDIC has held to this fundamental distinction between standby and other letters of credit for fifty years and its construction has been confirmed by commentators, case law and regulation.

The Court of Appeals' reasoning to the contrary is fallacious. In reaching the conclusion it did, the court relied upon the fact that once a bank becomes liable under a standby letter of credit, it has almost no real defenses. The bank may only dishonor a claim if the presented documents contain irregularities and thus faces nearly absolute liability. This is by definition true of all letters of credit (U.C.C. §5-114(1) (1985); *cf.* Uniform Customs and Practice for Documentary Credits, general provisions and definitions, (1983 Revision), International Chamber of Commerce Publication No. 400) but does not settle the question of whether the issuing bank is "primary liable" within the meaning of the statute. It merely means that once the contingency invoking the bank's liability occurs, the bank is liable on its agreement to pay, which in the standby letter of credit context is secondary to the primary obligation of another. The court's construction disregards this distinction, which is drawn in the statue itself by the use of the

phrase "primarily liable" and thus contravenes one of the cardinal principles of statutory interpretation, i.e. that significance and effect should if possible, be accorded every word of an act. *McDonald v. Thompson*, 305 U.S. 263 (1938), *reh'g denied*, 305 U.S. 676 (1939).

b. An unfunded standby letter of credit supported by a "contingent note" does not evidence receipt of "money or its equivalent" under 12 U.S.C. §1813(l)(1) because the "contingent note" is not a "promissory note" within the meaning of that section.

As noted earlier, a deposit is defined under the Act as, *inter alia*,

> the unpaid balance of money or its equivalent received or held by a bank...which is evidenced by a letter of credit... *Provided*, That, without limiting the generality of the term "money or its equivalent", any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks, or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable. 12 U.S.C. §1813(l)(1).

The Court of Appeals held that the standby letter of credit at issue was issued in exchange for a "promissory note" and that the letter of credit therefore evidenced "money or its equivalent."

Nothing in the Act itself nor in the legislative history expressly defines the scope of the term "promissory note" and the Court of Appeals did not attempt to define the term. Rather, it appears to have merely relied on the fact that the "note" was a "form note with standard terms." 751 F.2d at 1135. In so doing, it apparently assumed that the term "promissory note" should include all notes. Yet it is well-established that the manifest intent of the Congress must prevail over the common definition of specific words. *Minnesota Mining & Mfg. Co. v. New Jersey Wood Finishing Co.*, 381 U.S. 311 (1965); *Fleischmann Constr. Co. v. U.S.*, 270 U.S. 349 (1925); *Shelby v. Guy*, 24 U.S. 361 (1826). This principle is crucial here since the lower court's approach clearly operates to defeat the purpose of the Act.

The Act was "designed to prevent the destruction of deposits because of bank failure and to protect depositors against loss." S. Rep. No. 1821, 86th Cong., 2d Sess. (1960) *reprinted in* 1960 U.S. Cong. & Ad. News 3234. In other words, it was intended to protect those who entrust funds to a bank against the risk that the bank will become insolvent. It is crystal-clear, in the present context, that Orion's "note" cannot seriously be considered an entrustment of funds with Penn Square. Penn Square and Orion understood that nothing would be considered due on the note and no interest would be charged unless and until the letter of credit was acted on by the beneficiary. The bank extended no funds to anyone. The "transaction" was not a transfer of money or its equivalent, but rather at most an exchange of various conditional promises. No present indebtedness existed. From the perspective of both Penn Square and Orion, the transaction merely created a contingent liability. Since the conditions underlying these promises did not occur prior to, or by reason of, Penn Square's insolvency, no deposited funds were lost as a result of the insolvency.*

If the note is nevertheless treated as an insured deposit, Orion (through its beneficiary, the respondent) will enjoy a windfall because it will have been "reimbursed" by federal deposit insurance even though it never made a deposit with Penn Square. It cannot be seriously be contended that Congress intended such a novel and clearly unfair result.

The legislative history of the Act further indicates that Congress intended the term "promissory note" to have a limited construction. During Congressional hearings on the 1960 amendments which adopted the language of the FDIC'S Regulation I, the first detailed definition of the term "deposit", the FDIC made it clear that not every promissory note creates a deposit

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* The Court of Appeals' holding that a contingency which occurs after insolvency may be treated as creating a provable claim does not effect this conclusion. The court was not addressing the cause of the loss but rather the timing of the loss. The court's holding on this issue assumes that the item involved is a deposit. *Philadelphia Gear Corporation*, 751 F.2d at 1138.

liability under Regulation I. The FDIC stated that a promissory note received by the bank as security against a loan does not create a deposit:

> For instance, when a bank receives a promissory note and holds it as security for an obligation to the bank, there is no deposit liability; however, if the bank purchases that promissory note and gives credit for the purchase price thereof, a liability is created which is a deposit. *Hearings on H.R. 8916 and H.R. 8928 before the Subcommittee of the House Committee on Banking and Currency*, 86th Cong., 2d Sess. (1960) at 26.

In other words, a promissory note does not create a deposit liability if it is merely a further evidence of the reimbursement obligation of the customer to the issuing bank set forth in the usual letter of credit between a bank and its customers.

Congress thus understood that the term "promissory note", as used in Regulation I, had been assigned a limited meaning. It was free to reject this meaning. Instead, it adopted the language of Regulation I without modification. As this Court has stated,

> Congress is presumed to be aware of an administrative or judicial interpretation and to adopt that interpretation when it re-enacts a statute without change....So too, where, as here, Congress adopts a new law incorporating sections of a prior law, Congress can normally be presumed to have had knowledge of the interpretation given to the incorporated law at least as it affects the new statute.

Lorrillard v. Pons, 434 U.S. 575, 580-81 (1978) (citations omitted); *see also Albemarle Paper Co. v. Moody*, 422 U.S. 405, 414 n.8 (1975); *NLRB v. Gullett Gin Co.*, 340 U.S. 361 (1951); *National Lead Co. v. U.S.*, 252 U.S. 140 (1920); 2A C. Sands, *Sutherland on Statutory Construction*, §49.09 (4th ed. 1973).

c. An unfunded standby letter of credit supported by a "contingent note" does not evidence receipt of money or its equivalent because the "contingent note" was not given "in exchange for" the issuance of the standby letter of credit.

The statute provides that a letter of credit will be regarded as evidencing the receipt of the equivalent of money when credited or issued *in exchange for* checks, drafts or promissory notes. 12 U.S.C. §1813(l)(1). The standby letter of credit in the present case was not issued "in exchange for" Orion's note. It is well-settled that a person on whose behalf a bank issues a standby letter of credit is obligated to reimburse the bank in the event that the letter of credit is drawn on. U.C.C. §5-114(3), U.C.P. §16(a).[3] In this case, no agreement to the contrary appears to have varied this well-established rule.

When Orion requested Penn Square to issue a standby letter of credit, it was by law obligated to reimburse Penn Square should Penn Square be called upon to pay out on the letter of credit. The note did not create this obligation. It merely further evidenced the obligation. It does not appear that it was a necessary element in the transaction. It does not appear to have been separately bargained for and confers no rights beyond those accorded by operation of law. The letter of credit was not issued in exchange for the "contingent note" but rather for a fee and the legally established reimbursement obligation.

Neither funds nor their equivalent are entrusted to a bank when a customer merely provides a "contingent note" such as the one at issue here. This being the case, there can be no loss due to insolvency and thus no benefit in insuring against such a loss. If the Court of Appeals' holding is permitted to stand and the FDIC attempts to levy premiums on issuers of standby letters of credit of the sort in issue here, United States banks will run the risk of being required to pay very substantial amounts in unanticipated premiums, the FDIC may suddenly face a greatly increased potential insurance liability and users of standby letters of credit may be forced to pay higher fees all so that a nonexistent risk of loss may be insured. In addition there is a possibility

of such letters of credit becoming classified as deposits for other purposes such as reserve requirements. The result for CIB members and other banks may be exposure to millions of dollars of additional expense which would neither enhance the financial soundness of the banking industry nor provide additional protection for bank depositors.

II. The FDIC's interpretation of 12 U.S.C. §1813(l)(1) is entitled to the greatest deference.

The Court of Appeals also erred by using an improper standard of review of the FDIC's actions. In *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, No. 82-1005 (June 25, 1984), slip op. 5, this Court held that a federal agency's views must be given "controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute." *See also Federal Election Commission v. Democratic Senatorial Campaign Commission*, 454 U.S. 27, 39 (1981); *Train v. National Resource Defense Council*, 421 U.S. 60, 75 (1975); *Zenith Radio Corp. v. U.S.*, 437 U.S. 443, 450 (1978); *Udall v. Tallman*, 380 U.S. 1 (1965); *Unemployment Compensation Comm'n v. Aragon*, 329 U.S. 143 (1946).

In the present case, the Court of Appeals rejected the FDIC's interpretation of the term "deposit". It approached the issue of the construction of the statute as if its role was *de novo* interpretation of the statute, as opposed to a determination of whether the FDIC's construction was sufficiently reasonable. As discussed earlier, the Court of Appeals' analysis of the term "deposit" was clearly incorrect. Yet even if the court had reasonable grounds to conclude that the note was a "deposit", the standard of review dictated by *Chevron* would require the court to defer to the FDIC's interpretation.

The FDIC's position in this action is identical to that which it articulated in 1935, the year that it promulgated its Regulation I pursuant to authority granted under the Banking Act of 1935, Ch. 614, 49 Stat. 684. Regulation I was the first detailed definition of the term "deposit". It provided that the term included

letters of credit when issued for "money or its equivalent" or for a charge against a deposit account and also provided that letters of credit would be regarded as representing the equivalent of money when issued in exchange for "checks or drafts or promissory notes upon which the person procuring...the [letter of credit] is primarily or secondarily liable." 12 C.F.R. §301.1 (1939 Edition) *quoted in Irving Trust Co.*, 137 F.Supp. at 148.

At the time it promulgated Regulation I, the FDIC specifically explained that certain letters of credit do not represent deposits under the regulation:

> If your letter of credit is issued by a charge against a depositor's account or for cash and the letter of credit is reflected on your books as a liability, you do have a deposit liability. If, on the other hand, you merely extend a line of credit to your customer, you will only show a contingent liability on your books. In that event no deposit liability has been created. *Transcript of Notes Taken at Special Meeting of the New York Bank Auditors and Comptrollers Conference, held on September 27 and 28, 1935 at 25-26 quoted in F.D.I.C. v. Irving Trust Co.*, 137 F. Supp. 145 (D.C.N.Y. 1955).

The FDIC has never altered its interpretation of the definition of a deposit. In *Irving Trust*, the FDIC repeated its position that letters of credit only represent deposits to the extent of the cash or its equivalent entrusted to the bank by the customer. As the courts have held, longstanding agency practice "should be given great weight because of the frequent consistency and longevity of its construction and the reliance placed thereon by the agency...." *Young v. Tennessee Valley Authority*, 606 F.2d 143 at 146 (6th Cir. 1979); see *Red Lion Broadcasting Co.*, 395 U.S. at 382.

The FDIC is the type of agency to which deference should presumptively be afforded because of the scope of its authority. *F.D.I.C. v. European American Bank Trust Co.*, 576 F. Supp. 950, 954 (S.D.N.Y. 1983). The Court in that case also found that deference was due the FDIC because of its expert knowledge of commercial banking.

This Court has also recognized that courts should particularly avoid disturbing an agency's decision where, as here, the parties subject to regulation by an agency have relied on longstanding administrative practice and would be harmed by the reversal. *Tallman*, 380 U.S. at 18. In structuring their letter of credit transactions, United States banks have relied on the FDIC's longstanding position that standby letters of credit secured by contingent notes do not represent deposits. If the Court of Appeals' decision is upheld, these banks may have to contend with the prospect of very substantial increases in insurance premiums or reserve levies or both. Moreover, the Court of Appeals' decision would enormously increase the potential insurance liability of the FDIC by bringing within the ambit of insurance protection over $100 billion in standby letters of credit. The cost of standby letters of credit would thus necessarily increase as banks passed along the cost of additional insurance premiums or reserve requirements to the customer seeking to open such credits.

Congress enacted into law the language of Regulation I when it amended the Federal Deposit Insurance Act. 74 Stat. 546 (1960). The FDIC testified in hearings prior to the adoption of the 1960 amendments. *Hearings on H.R. 8916 and H.R. 8928 before the Subcommittee of the House Committee on Banking and Currency*, 86th Cong., 2d Sess. (1960). This Court has repeatedly held that an agency's interpretation is entitled to great deference when the agency participated in drafting the statute in question. *Red Lion Broadcasting Co. v. F.C.C.*, (1979); *U.S. v. American Trucking Associations Inc.*, 310 U.S. 534, 549 (1940).

Congress has adopted the FDIC's language and thus its interpretation of the term. When it enacted the Federal Deposit Insurance Act of 1950, it did not alter the FDIC's long standing definition although it substantially altered the existing federal deposit insurance program in other ways. 64 Stat. 684.

III. The Court of Appeals' Interpretation of 12 U.S.C. §1813 (l)(1) conflicts with commercial reality and long-established understanding of the commercial world.

A ruling which treats a standby letter of credit secured by a "contingent note" as evidencing the receipt of "money or its equivalent" also disregards commercial reality, a fact recognized in other cases. In *In re F&T Contractors, Inc.*, 718 F.2d 171 (6th Cir. 1983), the United States Court of Appeals for the Sixth Circuit held that a standby letter of credit secured by a mortgage note was properly treated as a contingent liability and not a deposit liability.*

This recognition by the courts is consistent with the long and widely held view of the banking industry and the commercial world generally. The members of the banking community have never suggested that a letter of credit is a deposit. The members of the CIB are amazed at a court ruling which does so.

A deposit is universally understood to involve the receipt by a bank of money, securities or other property which or the equivalent of which the bank is obliged to return or for which it becomes indebted to the depositor.

In contrast, a letter of credit has been understood to be a commercial tool designed to facilitate commercial and financial transactions by effectuating payment among parties of very disparate interests and locations. The purposes of these payments cover the

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* Other cases have suggested that letters of credit generally represent contingent and not deposit liabilities. In *Sprague v. U.S.*, 627 F.2d 1044, 1049 n.8 (10th Cir. 1980), the court stated that a letter of credit is "not an evidence of indebtedness. It is merely a promise by a bank to lend money under certain circumstances." *See Sisalcords Do Brazil, Ltd. v. Fiacoio Brasileira De Sisal, S.A.*, 450 F.2d 419, 422-23 (5th Cir. 1971) *cert. den.* 406 U.S. 919 (1972). The drafters of the Uniform Commercial Code have also recognized this economic reality. In their official comments to U.C.C. §5-117 they noted that

> A bank which issues a letter of credit...engages its own credit. But the resulting liability is not like that to its depositors, and the security and indemnity furnished by the customer against it and the documents which it receives on honor of complying drafts are not like its own investments.

range from purchase of goods to securing performance or guarantying a payment or other obligation. A bank lends its credit and earns a fee. The letter of credit has been understood to serve this purpose since its development centuries ago.

To now treat the letter of credit as a deposit would be contrary to established concepts as to what a letter of credit is and what it is not. Even if the language of the Act might support such a construction of the term, this Court should be careful to avoid such a construction which so conflicts with the understanding of the entire banking community and the commercial world generally.

Respect for the purpose of the Act, the weight of judicial authority, commercial reality, the expertise of the FDIC, the consensus of numerous commentators, common understanding and centuries of commercial and financial practice require that the Court of Appeals' decision be reversed.

CONCLUSION

For the foregoing reasons, the Court should reverse the Tenth Circuit's decision.

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APPENDIX A

12 U.S.C. §1813(l)(1)

§1813. Definitions

As used in this chapter-

(l) The term "deposit" means-

(1) the unpaid balance of money or its equivalent received or held by a bank in the usual course of business and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or which is evidenced by its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank, or a letter of credit or a traveler's check on which the bank is primarily liable. *Provided*, That, without limiting the generality of the term "money or its equivalent", any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange for checks or drafts or for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable, or for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such bank for collection.

AMICUS CURIAE

BRIEF

Supreme Court, U.S.
FILED
DEC 5 1985
JOSEPH F. SPANIOL, JR.
CLERK

No. 84-1972

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

v.

PHILADELPHIA GEAR CORPORATION,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

---

BRIEF OF THE NATIONAL ASSOCIATION OF BOND LAWYERS AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether a standby letter of credit that is backed by a promissory note is a "deposit" within the meaning of 12 U.S.C. 1813(*l*)(1).

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IN THE

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CONSENT OF THE PARTIES

Petitioner and Respondent have consented to the filing of this brief and their letters of consent have been filed with the Clerk of the Court.

INTEREST OF THE *AMICUS*

The *amicus* was incorporated as an Illinois non-profit corporation on February 5, 1979, for the purposes of educating its members and others in the law relating to state and municipal bonds and other obligations, providing a forum for the exchange of ideas as to law and practice, improving the state of the art in the field, providing advice and comment at the federal, state and

local levels with respect to legislation, regulations, rulings and other action, or proposals therefore, affecting state and municipal obligations, and providing advice and comment with respect to state and municipal obligations and proceedings before courts and administrative bodies through briefs and memoranda as a friend of the court or agency. Its members are attorneys who represent state, county and municipal governments, banks and other financial institutions, and various other private entities involved in the area of public finance throughout the United States as issuers, borrowers, banks, purchasers or underwriters.

This case presents the question whether a letter of credit is a "deposit" within the meaning of 12 U.S.C. § 1813(*l*)(1) for purposes of federal deposit insurance. The resolution of that issue will determine whether or not a letter of credit is insured by the Federal Deposit Insurance Corporation ("FDIC"). If a letter of a credit is FDIC-insured, then obligations backed by such letters, the interest on which is otherwise tax-exempt under Section 103(a) of the Internal Revenue Code of 1954, as amended, are federally guaranteed, and, therefore, taxable.

Issues affecting or having the potential to affect the tax-exempt status of state and municipal bonds are vitally important to the *amicus* and its members, who are called upon to advise their clients and give opinions with respect to the tax-exempt status of state and municipal bonds. The decision in this case is particularly important because of its potential impact on an essential source of financing for public and quasi-public development. Approximately $114 billion worth of tax-exempt state and municipal bonds were issued in 1984, a substantial portion of which were supported by letters of credit. It is expected that a comparable amount of bonds supported by letters of credit will be issued in 1985 and 1986. Bonds issued in 1986 and thereafter can enjoy tax-exempt status only if, contrary to the Tenth Circuit's holding, the letters of credit supporting them are not deposits within

the meaning of 12 U.S.C. § 1813(*l*)(1) and, therefore, are not federally guaranteed.

This Court's decision in this case will have an immediate and significant effect on the municipal bond market and, therefore, on the practices of the *amicus* and its members. In order to assist this Court in its endeavor to justly and properly decide this case, the *amicus* respectfully submits this brief.

STATEMENT OF THE CASE

Respondent in this case is the beneficiary of an irrevocable standby letter of credit issued on April 23, 1981 by Penn Square Bank, N.A. ("Penn Square") upon the application of Orion Manufacturing Corporation ("Orion"), a customer of the respondent. Penn Square issued the letter of credit without the deposit of any funds by Orion. All that Penn Square obtained was an unsecured, "contingent note" which matured on the day the letter of credit expired. No interest was to be charged and nothing was due on this note prior to the presentation of the documents required under the letter of credit. The understanding between the parties was that Penn Square would have no claim against Orion unless and until the bank was called upon to make an advance under the letter of credit. Thus, no actual indebtedness existed at the time the "contingent note" was delivered.

On July 5, 1982, the Comptroller of the Currency declared Penn Square insolvent and respondent thereafter sought payment under the letter of credit. The FDIC, in its capacity as receiver, stated that it had no obligation under the letter of credit. The respondent then sued the FDIC in its capacity as insurer for deposit insurance proceeds, claiming that the letter of credit represented a deposit, as the term is defined in 12 U.S.C. § 1813(*l*)(1) of the Federal Deposit Insurance Act.

The United States District Court for the Western District of Oklahoma held that the letter of credit did represent a deposit. *Philadelphia Gear Corporation v. FDIC*, 587 F. Supp. 294 (W.D. Okla. 1984). The FDIC appealed that determination to the Tenth Circuit Court of Appeals which affirmed the District Court's holding. *Philadelphia Gear Corporation v. FDIC*, 751 F.2d 1131 (10th Cir. 1984).

The case turns upon the meaning of the term "deposit" in 12 U.S.C. § 1813(*l*)(1).

ARGUMENT

I. *The FDIC's Arguments and Analysis Present a Correct Statement of the Law.*

The *amicus* endorses the arguments, analysis and results presented by the FDIC in its brief to this Court.

II. *The Arguments and Analysis of the U.S. Conference of Mayors, et al., Present a Correct Statement of the Law.*

The *amicus* endorses the arguments, analysis and results presented by the U.S. Conference of Mayors *et al.* in their brief to this Court.

CONCLUSION

For the foregoing reasons, the decision of the Tenth Circuit should be reversed.

Respectfully submitted,

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AMICUS CURIAE

BRIEF

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On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF OF THE U.S. CONFERENCE OF MAYORS, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL LEAGUE OF CITIES, NATIONAL ASSOCIATION OF COUNTIES, AND INTERNATIONAL CITY MANAGEMENT ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether an unfunded standby letter of credit supported by a "contingent note" is a "deposit" as defined in 12 U.S.C. § 1813(*l*)(1).

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BRIEF OF THE U.S. CONFERENCE OF MAYORS, NATIONAL GOVERNORS' ASSOCIATION, NATIONAL LEAGUE OF CITIES, NATIONAL ASSOCIATION OF COUNTIES, AND INTERNATIONAL CITY MANAGEMENT ASSOCIATION AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

INTEREST OF THE *AMICI CURIAE*

The *amici* are organizations whose members include state, county, and municipal governments and officials located throughout the United States. *Amici* and their members, therefore, have a vital interest in the legal issues that affect the powers and responsibilities of state and local government.

The court below held that a standby letter of credit is a deposit within the meaning of 12 U.S.C. § 1813 (*l*) (1)

for purposes of the federal deposit insurance program. This holding, if not reversed by this Court, will have a dramatic adverse effect on tax-exempt bonds issued by state and local governments. Over $114 billion worth of such bonds were issued in 1984.[1] That amount is expected to increase by at least 15% in 1985. Over $500 billion worth of municipal bonds are now outstanding.[2] These bonds, which provide an essential source of financing for state and local government projects, are generally issued using unfunded bank letters of credit. Because the bonds cannot enjoy tax-exempt status if those letters of credit are FDIC-insured, the Tenth Circuit's holding, in effect, strips the bonds of their tax-exempt status, severely impairing their value in the market. Without the availability of tax-exempt bonds, interest rate costs to state and local governments would increase by approximately 30%.[3]

Amici submit that the decision below is erroneous under the federal deposit insurance law. Because the decision will have a direct and immediate adverse effect on matters of compelling importance to *amici* and their members, *amici* submit this brief to assist the Court in its resolution of the case.[4]

INTRODUCTORY STATEMENT

1. Philadelphia Gear Corporation ("Philadelphia Gear"), the respondent in this case, is the beneficiary of an irrevocable standby letter of credit issued on April 23,

[1] Joint Comm. on Taxation, 99th Cong., 1st Sess., *Tax Reform Proposals: Tax Treatment of State and Local Bonds*, Table 1.

[2] Joint Stipulation of Facts, ¶ 8, *South Carolina v. Baker*, No. 94, Orig.

[3] This computation was made by comparing the interest rates of tax-exempt municipal bonds with comparably rated corporate bonds.

[4] Pursuant to Rule 36 of this Court, the parties have consented to the filing of this brief. Their letters of consent have been filed with the Clerk of the Court.

1981, by Penn Square Bank, N.A. ("Penn Square") to Orion Manufacturing Corporation ("Orion"), a customer of the respondent. Consistent with normal business practice, Penn Square issued the letter of credit without a deposit of any funds whatsoever by Orion. All that Penn Square obtained was an unsecured "contingent note" that would have lapsed without the necessity of payment of either principal or interest on the day that the letter of credit expired. Customary business practice and law would require payment by Penn Square on this contingent note only upon fulfillment of the conditions found in the letter of credit, including the presentation by respondent to Penn Square of documents and invoices evidencing Orion's obligation to pay respondent and Orion's subsequent failure to pay. Then, and only then, could respondent look to Penn Square for advances against invoices. Then, and only then, would Penn Square have been obligated to pay respondent on the letter of credit. Upon payment to respondent, Penn Square would have had rights to reimbursement according to the terms of the contingent note. At no time during the entire course of this transaction, as contemplated and structured by the parties, would Orion deposit any funds in Penn Square in connection with this transaction; and, in fact, there was never any such deposit.

2. On July 5, 1982, the Comptroller of the Currency declared Penn Square insolvent. Respondent thereafter presented to the Federal Deposit Insurance Corporation ("FDIC"), as receiver, a total of eight drafts, seeking payment under the letter of credit. When payment was denied, respondent sued the FDIC, in its capacity as insurer, for $100,000 in deposit insurance proceeds, alleging that the letter of credit represented a deposit within the meaning of the Federal Deposit Insurance Act ("FDIA"), 12 U.S.C. § 1813(*l*)(1).[5]

[5] Respondent also sued the FDIC in its capacity as receiver for the bank. That claim is not before this Court. *See infra* at 7.

3. The United States District Court for the Western District of Oklahoma held that the letter of credit represented a deposit. *Philadelphia Gear Corp. v. FDIC*, 587 F. Supp. 294 (W.D. Okla. 1984). On the FDIC's appeal to the Tenth Circuit Court of Appeals, that court affirmed. *Philadelphia Gear Corp. v. FDIC*, 751 F.2d 1131 (10th Cir. 1984).

4. This case, which involves a bank that issued a letter of credit backed by a contingent note to a supplier on behalf of a customer for payment for goods, could only in the most extraordinary circumstances be of interest to state and local governments. The decision of the Tenth Circuit, however, creates just such circumstances.[6] Unwittingly, the court below issued a decision with a potentially devastating effect on the municipal bond market.[7] Over $110 billion in municipal obligations are issued each year. Many of these transactions use bank letters of credit for the interim transfer of funds.[8]

5. One of the very attractive features of municipal obligations for investors is that the interest on them is exempt from federal taxation. Internal Revenue Code of 1954, 26 U.S.C. § 103. In enacting the Deficit Reduction Act of 1984 ("DEFRA"),[9] however, Congress ex-

[6] The FDIC, too, regards the decision below as extraordinary. The petition for *certiorari* cites the new demands on the federal deposit insurance program and the disruption in the national market in industrial revenue bonds as factors compelling review by this Court, even in the absence of a conflict in the decisions of the courts of appeals on the question presented. *See* Pet. 21 n.14.

[7] We use the term "municipal bonds" as it is used in the financial market to refer to state and local obligations. Such bonds are used for the financing of hospitals, schools, and water and sewer projects, among others. They include more than the "industrial revenue bonds" whose tax-exempt status is of concern to the FDIC.

[8] In government finance, letters of credit are used as a credit enhancement device to increase the credit rating of bonds and to lower the interest rate.

[9] Pub. L. No. 98-369, 98 Stat. 494 *et seq.*

plicitly provided that municipal obligations that are federally guaranteed would lose their tax-exempt status. 26 U.S.C. § 103(h)(1). The Tenth Circuit's decision seriously threatens the ability of state and local governments to raise necessary revenue, because it will undermine the value of their bonds and force them from the use of letters of credit that involve the national banking system and the FDIC.

An additional attractive feature of municipal bonds for investors is their stability and predictability over many years. The threat of the loss of tax exemption disrupts that stability and will lead to higher interest costs, costs that are borne by state and local taxpayers.

6. The Tenth Circuit's decision threatens seriously to disrupt both the federal financial insurance program and the municipal bond market. The FDIC predicts numerous problems that will arise from the decision below, including additional reserve requirements and increases in insurance premiums. *See* Pet. 7, 20. The decision below also creates immense new difficulties for state and local governments issuing tax-exempt bonds. The decision casts doubt on the time-honored construction of letters of credit that are commonly used as bank guarantees of bond funds in order to avoid the risks and inconvenience attendant upon the actual deposit of large sums of money.

7. The Tenth Circuit's decision transforms almost every commercial transaction involving a letter of credit secured by a contingent note into a federally guaranteed event, significantly increasing costs to the banking industry, consumers, public entities, and, finally, to federal, state, and local taxpayers. Because these letters of credit are unfunded, providing insurance for them will require that premiums be drawn from legitimate, funded, insurable accounts.[10] In addition, if capitalization requirements attach to letters of credit that become "de-

[10] It would also substantially increase the charge for letters of credit.

posits" under this decision, billions of dollars will be removed from the flow of productive capital in the economy.[11]

8. The effect of the decision will be to force state and local governments to seek alternative means for issuing municipal bonds, avoiding the national banking system. They could turn to non-insured institutions, which would increase costs and decrease the value of the bonds, or to foreign banks, whose use would exacerbate current foreign trade deficit problems. *See* Pet. 20, 21. Thus, each of the available alternatives would ultimately degrade the value and thereby increase the interest cost of municipal bonds.

9. For state and municipal bond issuers, this case reflects the tension between equally laudable, but unrelated, goals of Congress. The purpose of the FDIA is to ensure that a depositor who entrusts funds to a member institution will be protected against loss. The relevant provisions of DEFRA were designed to address problems that Congress perceived of so-called "double-dipping" by issuers of municipal bonds. Congress did not want municipal issuers to be able to look to the federal government *both* for tax-exempt status and, concurrently, for insurance of the issue and its purchasers against loss. Ironically, this case creates a conflict between the two purposes in the context of a payment mechanism regularly used for the convenience that it brings to both public and private financial transactions. The circumstances of this case clearly indicate that the Tenth Circuit's sweeping decision, as applied to municipal issuers, is directly contrary to Congress's intent in DEFRA. As we explain more fully below, Congress's intent to prevent "double-dipping" is fully consistent with the continued tax exemption of municipal bond issues backed by unfunded letters of credit. In fact, DEFRA specifically

[11] The FDIC estimates up to $6.5 billion in additional capitalization requirements. *See* Pet. 20 n.13.

provides that an obligation shall not be treated as federally guaranteed "merely by reason of the fact that the proceeds of such issue are used in making loans to a financial institution or there is a guarantee by a financial institution." 26 U.S.C. § 103(h)(3)(D).

10. Private companies, such as respondent, have several remedies available to them in situations like this case. Fairness does not require that the FDIC become their guarantor. For example, the Uniform Commercial Code provides rights and procedures for perfecting security interests. U.C.C. §§ 2-401, 9-303. In addition, of course, state contractual remedies are available, as are federal bankruptcy or bank insolvency proceedings. The FDIC did not challenge in this Court the Tenth Circuit's holding that respondent has rights against it as Penn Square's receiver. At some point, however, respondent came to believe that it was better to pursue the significantly deeper, if somewhat more elusive, pockets of the FDIC than the pockets of an insolvent bank or a customer that was already long in default on payments. Surely there are better uses for the allocation of federal deposit insurance funds than as a bailout for poor commercial judgments made by businesses presumably dealing in good faith and at arm's length.

11. State and local governments and the purchasers of their bonds are on notice that, under DEFRA, municipal issuers cannot seek a double benefit on their bonds; and, in fact, they have not. At least until the Tenth Circuit's decision, no one had thought, and no court had held, that state and local government bonds are federally guaranteed merely because they may utilize an unfunded standby letter of credit at a federally insured bank as part of the financial transaction of the issurance itself. It is simply wrong to force a very significant part of state and local government financing out of the insured national banking system solely on the basis of a strained definition of "deposit" in a private

commercial dispute having nothing to do with the tax-exempt status of municipal bonds.

This case casts unnecessary and unjustifiable doubt on clearly understood relations in both public and private financial markets. For years, those markets have relied on the use of letters of credit as an efficient means of guaranteeing, rather than actually causing, the flow of funds through public and commercial transactions. It is just not reasonable to assume that Congress would have cavalierly, indeed, silently, imperiled the tax-exempt status of municipal obligations.[12]

SUMMARY OF ARGUMENT

I. *Amici* agree with the arguments, analysis, and request for relief of the FDIC in its petition for *certiorari*.

II. Congress's enactment of 26 U.S.C. § 103(h)(3)(D), as part of DEFRA, evidences its understanding that an unfunded letter of credit is not a "deposit" within the meaning of 12 U.S.C. § 1813(*l*)(1). DEFRA amended § 103(h) of the Internal Revenue Code to provide that a tax exemption will be denied to interest on federally guaranteed obligations. 26 U.S.C. § 103(h)(1). DEFRA further provides that "an obligation which is issued as part of an issue shall not be treated as federally guaranteed merely by reason of the fact that . . . there is a guarantee by a financial institution." 26 U.S.C. § 103(h)(3)(D).

The legislative history makes clear that Congress intended to allow financial institutions to back tax-exempt bond issues with letters of credit. Such letters of credit are, without exception, backed by some form of reimbursement agreement. If such a letter of credit is a "deposit" within the meaning of 12 U.S.C. § 1813(*l*)(1),

[12] Such a course, moreover, raises difficult constitutional questions, some of which are now being litigated in *South Carolina v. Baker*, No. 94, Orig.

then it is federally guaranteed, and its use in connection with a municipal bond issue will destroy the tax-exempt status of that issue. Thus, it was Congress's understanding and intent that an unfunded letter of credit backed by a contingent note was not a "deposit" within the meaning of 12 U.S.C. § 1813(*l*)(1).

ARGUMENT

I. The FDIC's Arguments and Analysis Present a Correct Statement of the Law

Amici agree with the arguments, analysis, and request for relief of the FDIC in its petition for *certiorari*.

II. Congress Understood "Deposit" Under 12 U.S.C. § 1813(*l*)(1) to Exclude Unfunded Letters of Credit

DEFRA amended § 103(h) of the Internal Revenue Code of 1954, to provide that a state or local obligation shall not be treated as tax-exempt if it is federally guaranteed. 26 U.S.C. § 103(h)(1). DEFRA also provided, however, that "an obligation which is issued as part of an issue shall not be treated as federally guaranteed merely by reason of the fact that . . . there is a guarantee by a financial institution." 26 U.S.C. § 103(h)(3)(D). The legislative history of DEFRA's amendment to § 103(h) provides useful guidance in understanding Congress's intention in amending the provision.

The Conference Report states that "[t]he conference agreement generally follows the House bill, except for certain transitional rules . . . ." Conf. Rep. No. 861, 98th Cong., 2d Sess. 1205 (1984). The House Report on the bill, in turn, explained that the intent in amending § 103(h) was to address the problem of "double dipping." H.R. Rep. No. 4170, Pt. 2, 98th Cong., 2d Sess. 1684-85 (1984) ("House Report"). That is, the House felt, for various reasons, that it was inappropriate to permit obligations to receive a double federal subsidy by being

granted tax-exempt status and being federally guaranteed as well.[12] Significantly, however, the House's explanation of the relevant provision stated that an "exception to the general denial of tax-exemption provides that obligations shall not be treated as Federally guaranteed solely because . . . a financial institution guarantees repayment of the loans (e.g., issues a letter of credit)." House Report at 1690.

The Joint Committee on Taxation endorsed the House's explanation, also citing the example of a letter of credit as a financial institution guarantee that would not be treated as federally guaranteed. That Committee's report stated that "obligations are not treated as Federally guaranteed . . . because a financial institution guarantees repayment of the loans *other than by means of Federal deposit insurance (e.g., by a letter of credit)*" (emphasis added). Joint Comm. on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* at 941 (Comm. Print 1984). This explanation by the Joint Committee, which specifically cites a letter of credit as an example of a financial institution guarantee that does not result in a federal guarantee, is controlling of the meaning of deposit at issue in this case.

This definition is critical because if a letter of credit backed by a contingent note were a "deposit" under 12 U.S.C. § 1813(*l*)(1), then it would be federally guaranteed. As a result, payment of principal and interest on the tax-exempt obligation would be "indirectly guaranteed (in whole or in part) by the United States (or an agency or instrumentality thereof)," and such an

[12] Such a prohibited double federal subsidy would result, for example, where the proceeds of a tax-exempt issue of bonds are deposited in a bank or savings and loan account insured by the FDIC or the Federal Savings and Loan Insurance Corporation. House Report at 1680. In that situation, the amount of each bondholder's holding is insured to the extent of $100,000.

issue would, therefore, be taxable. 26 U.S.C. § 103(h)(2)(C).

In fact, as Congress must have realized, financial institutions, including national banks, almost without exception, use letters of credit to guarantee tax-exempt obligations. It is therefore, an inescapable inference from the statutory amendment to § 103(h) that tax-exempt issues that are guaranteed by letters of credit issued by financial institutions would be outside the definition of "deposit" under 12 U.S.C. § 1813(*l*)(1).

CONCLUSION

For all these reasons, the judgment of the Tenth Circuit Court of Appeals should be reversed.

Respectfully submitted,

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December 5, 1985

AMICUS CURIAE

BRIEF

Supreme Court, U.S.
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On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF OF WILLIAM H. ALLEN, *ET AL.*, AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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STATEMENT OF THE ISSUE

Whether letters of credit issued in exchange for promissory notes constitute insured deposits under Section 1813(*l*)(1) of the Federal Deposit Insurance Act.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

No. 84-1972

FEDERAL DEPOSIT INSURANCE CORPORATION,
Petitioner,

v.

PHILADELPHIA GEAR CORPORATION,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

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BRIEF OF WILLIAM H. ALLEN, *ET AL.*, AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

This brief is in support of the position of respondent Philadelphia Gear Corporation and is filed pursuant to Rule 36.2 of the Rules of this Court with the consent of both parties.

INTEREST OF *AMICI CURIAE*

William H. Allen and 24 other individuals or entities joining in this brief[1] hold standby letters of credit that

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[1] William H. Allen, Essie Applegate, Linda Earl Baskett, George E. Dowden, Eugene H. Fontaine, Mildred H. Forbes, Robert Goff, Julia W. Hall, Dr. Julian R. Hardaway, Joseph W. Hart, Lucy S. Leonardi, John H. McGehee, Kay McGehee, Virginia A. Miller, O.W.K.Y. & Co. (as trustee), E. Wayne Pace, Frank M. Reiman,

were issued in exchange for a promissory note and that are substantially similar to the letter of credit held by respondent Philadelphia Gear. *Amici* are among the former shareholders of Farmers Deposit Bank of Brandenburg, a small community bank in western Kentucky. In October 1982, *amici* and the 22 other shareholders sold their shares to C.H. Butcher and two associates for a combination of cash and notes made by Butcher. Butcher's notes to *amici* were backed by irrevocable standby letters of credit issued by United American Bank in Knoxville ("UAB Knoxville"), which issued the letters in exchange for a promissory note made by Butcher and his two associates. Following the failure of UAB Knoxville, FDIC purported to disavow the letters of credit, and it rejected *amici*'s claims under those letters.

Like respondent, *amici* relied on the credit of the bank that issued their letters and have been unable to obtain payment following the failure of that bank. Like respondent, *amici* filed suit claiming the deposit insurance to which they are entitled under section 1813(*l*)(1) of the Federal Deposit Insurance Act (the "FDIA" or the "Act"), 12 U.S.C. §§ 1811-1832 (1982). The district court after trial entered judgment upholding *amici*'s claim, and FDIC has appealed from that judgment. *Allen v. FDIC*, 599 F. Supp. 104 (E.D. Tenn. 1984), *appeal docketed*, No. 85-5003 (6th Cir. 1985).

The court of appeals held in the instant case that a letter of credit issued in exchange for a promissory note represents an insured deposit within the plain meaning of the FDIA. Several *amici curiae* have joined FDIC in urging this Court to disregard the words of the Act and overturn the judgment of the court of appeals. Among these *amici* are representatives of the banking industry

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Lorena S. Richardson, William P. Shumate, Estate of Lucy Smith, Irene W. Stith, Charles R. Thompson, James R. Watts, Gail H. Witten, Houston C. Woolfolk.

who are simply concerned that banks issuing letters of credit may have to pay additional deposit insurance premiums. Various participants in the municipal bond market have also suggested, based on a misunderstanding of one section of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, 98 Stat. 494 (1984) ("DEFRA"), that affirmance in this case may indirectly jeopardize the tax-exempt status of municipal bonds that are "enhanced" by standby letters of credit.

The *amici* joining in this brief are members of the public who rely on the credit of banks and on the stability of the banking system. Few organizations exist that represent members of the banking public, and no organization represents the interests of the few members of the public who hold standby letters of credit, let alone standby letters issued in exchange for promissory notes. Thus, *amici* must file this brief on their own behalf in order to respond to several misconceived arguments advanced by FDIC and others seeking to narrow the protection Congress provided to the banking public.

SUMMARY OF ARGUMENT

The FDIA clearly provides deposit insurance coverage for a letter of credit issued by an insured bank in exchange for a promissory note. This unambiguous statutory language is controlling.

Congress had good reason for providing deposit insurance coverage for this and other forms of bank liability. FDIC now insists that Congress' purpose in creating the federal deposit insurance system was a narrow one, aimed solely at protecting those who actually placed funds in insured banks. The Act's text, its legislative history, and its very structure demonstrate, however, that Congress sought to respond broadly to the erosion of public confidence in the banking system. Congress sought to bolster that public confidence not only by protecting those who place funds in banks, but by protecting many others who rely in various ways on the credit and stability of the

nation's banks. Congress achieved its broad purpose by providing federal insurance for many forms of bank liability, including certain liabilities evidenced by letters of credit.

FDIC attempts to distinguish the promissory note at issue in this case by urging that it did not constitute present value "entrusted" to the bank that issued respondent's letter of credit. This narrow theory of entrustment does not fully explain the scope of deposit protection provided under the FDIA. The definition of deposit, including the proviso referring to promissory notes, reflects a variety of congressional concerns, including the desire to extend protection—subject to various safeguards—to those who receive credit instruments from banks. The letter of credit issued to Philadelphia Gear was just such an instrument.

FDIC claims that despite the plain language of the FDIA, the Court should defer to an "informal" but allegedly long-standing administrative interpretation that would deny insurance coverage to Philadelphia Gear. Prior to this litigation, however, FDIC had never even articulated its purported interpretation, let alone adopted and applied it in a manner that would justify judicial deference.

FDIC also seeks support for its position by citing what it claims is the legislative history behind DEFRA provisions concerning the tax-exempt status of certain municipal bonds. Even if FDIC's reading of the 1984 legislative history were correct, it would prove nothing about the meaning of an FDIA provision enacted 24 years earlier. In fact, FDIC has misread the 1984 legislative history, which actually reveals Congress' understanding that letters of credit may qualify as insured deposits.

No calamity will result when this Court, like lower courts before it, gives effect to Congress' objectives, as reflected in the plain language of the FDIA. There is no evidence indicating that FDIC-insured institutions

have, in the past, issued substantial numbers of letters of credit in exchange for promissory notes. In the future, banks that wish to avoid creating insured obligations can simply refrain from taking promissory notes when they issue letters of credit. The treatment of letters of credit as insured deposits may soon change, in any event, as a result of FDIC-sponsored legislation that would eliminate all letters of credit from the FDIA definition of "deposit." Whether or not the current Congress chooses to alter the definition, there is neither reason nor legal justification for this Court to disregard the clear language of the FDIA.

ARGUMENT

I. The FDIA Clearly Affords Deposit Insurance Protection to the Holders of Letters of Credit Issued in Exchange for Promissory Notes.

The FDIA affords deposit insurance coverage to "the unpaid balance of money or its equivalent . . . which is evidenced by . . . a letter of credit . . . ." 12 U.S.C. § 1813(*l*)(1).[2] The Act requires that "any such . . . in-

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[2] Section 1813(*l*)(1) defines "deposit" for the purpose of determining, *inter alia*, what constitutes an "insured deposit" under § 1813(m). Section 1813(*l*)(1) defines "deposit" as

> *the unpaid balance of money or its equivalent received or held by a bank in the usual course of business* and for which it has given or is obligated to give credit, either conditionally or unconditionally, to a commercial, checking, savings, time, or thrift account, or *which is evidenced by* its certificate of deposit, thrift certificate, investment certificate, certificate of indebtedness, or other similar name, or a check or draft drawn against a deposit account and certified by the bank, or *a letter of credit* or a traveler's check on which the bank is primarily liable: *Provided, That*, without limiting the generality of the term 'money or its equivalent', *any such account or instrument must be regarded as evidencing the receipt of the equivalent of money when credited or issued in exchange* for checks or drafts or *for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable*, or

strument *must* be regarded as evidencing the receipt of the equivalent of money when . . . issued in exchange for . . . a promissory note upon which the person obtaining any such . . . instrument is primarily or secondarily liable . . . ." *Id.* (emphasis added). This unambiguous language precisely describes Philadelphia Gear's letter of credit, which was issued in exchange for a promissory note—the "equivalent of money"—on which the issuing bank's customer was primarily liable.

A. The FDIA's Plain Language, Structure, and Legislative History Establish That Letters of Credit Issued in Exchange for Promissory Notes Qualify as Insured Deposits.

FDIC and its allied *amici* disregard the plain meaning of the FDIA and contend that while deposit insurance extends to "funded" letters of credit (those issued by a bank in exchange for cash from its customer), it does not cover "unfunded" letters, such as those issued in exchange for the customer's promissory note. This invented distinction between "funded" and "unfunded" letters is squarely at odds with the statute on which it is purportedly based. The FDIA clearly requires that a letter "issued in exchange for" a promissory note "*must* be regarded as evidencing the receipt of the equivalent of money . . . ." 12 U.S.C. § 1813(*l*)(1) (emphasis added). Every court that has considered the question has given effect to this plain statutory language by holding that letters issued in exchange for promissory notes are insured deposits.[3]

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for a charge against a deposit account, or in settlement of checks, drafts, or other instruments forwarded to such banks for collection. [Emphasis added.]

[3] *Philadelphia Gear Corp. v. FDIC*, 587 F. Supp. 294 (W.D. Okla.), *aff'd*, 751 F.2d 1131 (10th Cir. 1984), *cert. granted*, 106 S. Ct. 245 (1985); *Allen v. FDIC*, 599 F. Supp. 104 (E.D. Tenn. 1984), *appeal docketed*, No. 85-5003 (6th Cir. 1985).

As respondent discusses more fully in its brief, this Court has long recognized its obligation to construe unambiguous statutory language according to its clear meaning:

> First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, *that is the end of the matter*; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.

Chevron, U.S.A., Inc. v. National Resources Defense Council, Inc., 104 S. Ct. 2778, 2781-82 (1984) (emphasis added). *Accord Consumer Product Safety Commission v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980).

The FDIA's unambiguous statutory language shows Congress' intent to afford deposit insurance protection to the holders of letters of credit issued in exchange for promissory notes. FDIC seeks to escape this plain language by mischaracterizing Congress' purpose in establishing the federal deposit insurance system. FDIC claims that Congress sought to protect only those who "entrust" their "hard earnings" to the nation's banks, and it cites snippets from the legislative history of the Banking Act of 1933, which, according to FDIC, evidence this limited congressional purpose. *See* FDIC Br. at 12-14. Both the history and the structure of the deposit insurance system reveal, however, that in establishing the federal insurance program, Congress sought to provide broader protection in order to promote public confidence in the stability of the banking system.

Congress created the deposit insurance system as one part of the Banking Act of 1933, Pub. L. No. 73-66, ch. 89, 48 Stat. 162 (1933), a statute that profoundly restructured the nation's banking system in response to the bank failures of the early 1930s. Congress recognized that these bank failures had sparked—and then been fueled by—a crisis of public confidence in the credit of

the banking system as a whole. S. Rep. No. 77, 73d Cong., 1st Sess. 6 (1933). Congress responded to that crisis by enacting the Banking Act of 1933. It restrained certain speculative lending practices, *e.g.*, ch. 89, § 13, 48 Stat. 183 (codified at 12 U.S.C. § 371a, as amended); it regulated "group banking" and bank affiliates engaged in "perilous underwriting operations" and "stock speculation;" S. Rep. No. 77, *supra* at 10; *e.g.*, ch. 89, § 13, *supra*; it took steps to curb the rate of bank insolvencies, *see* S. Rep. No. 77, *supra* at 11; and it created an insurance system to restore and promote the confidence of all depositors. Ch. 89, § 8, 48 Stat. 168 (adding § 12B to the Federal Reserve Act). As the House Committee on Banking and Currency explained:

> The use of bank credit has declined to the vanishing point. The public is afraid to deposit their money in the banks, and the banks are afraid to employ their deposits in the extension of bank credit for the support of trade and commerce. Business men and investors are victimized by the same fear. The result is curtailment of business, decline in values, idleness, unemployment, bread lines, national depression, and distress. We must resume the use of bank credit if we are to find our way out of our present difficulties.

H.R. Rep. No. 150, 73d Cong., 1st Sess. 6 (1933).

In 1935, Congress consolidated the "temporary" deposit insurance system created in 1933 into a "permanent" insurance fund. Banking Act of 1935, Pub. L. No. 74-305, 49 Stat. 684. *See* H.R. Rep. No. 742, 74th Cong., 1st Sess. 1 (1935). FDIC Chairman Leo T. Crowley, testifying in support of the bill, spoke of the importance of public confidence in the banking system as a whole:

> The benefits of deposit insurance are not limited solely to the protection of the individual depositor. The entire banking structure of the country is so intimately interwoven that a disturbance in any part of the system may cause repercussions of far-reaching

> proportions. . . . Banking is no longer merely a private business proposition. It involves great social consequences. The stability of the banking system affects the economic prosperity of the country.

Banking Act of 1935: Hearings on H.R. 5357 Before the House Comm. on Banking and Currency, 74th Cong., 1st Sess. 10 (1935).[4] Thus, the history of the Banking Acts of 1933 and 1935 shows that Congress' purpose in creating a deposit insurance system was far broader than simply protecting "hard earnings."

Congress' broad purpose is also reflected in the specific protections it has chosen to afford, for the FDIA clearly provides deposit insurance to many among the banking public who have placed nothing of value in any bank. For example, even under FDIC's theory, deposit insurance

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[4] FDIC officials meeting with New York bankers in September 1935 elaborated as follows:

> The obligations of the bank, other than its capital obligations, may be roughly divided into two classes; namely, obligations to depositors and obligations to creditors . . . . In making the distinction between a depositor and a creditor obligation, we immediately recognize a class of persons . . . who deal with the bank in respect to the bank's only commodity, its only stock in trade; namely, credit . . . . Congress has felt that these persons who are in the same position as a depositor should not be deprived of insurance protection because of any legalistic distinction between a depositor and a creditor. Consequently, the [1935] law contemplated extending the benefits of insurance to those persons who, under certain circumstances, accepted credit instruments of the bank, by treating such persons as depositors and such obligations as deposit obligations . . . .

Transcript of Notes Taken at Special Meeting of N.Y. Bank Comptrollers and Auditors Conference Held September 27 and 28, 1935 (the "1935 Transcript") at 1-2. As discussed at 18-19, *infra*, FDIC has previously repudiated the 1935 Transcript, and other portions of it have been held to have little evidentiary value. Nevertheless, FDIC's opening statement, echoing the testimony of its Chairman, presumably is an accurate indication of FDIC's contemporary view of the scope of the deposit insurance program.

is available to the beneficiary of a "funded" letter of credit. FDIC Br. at 17. Whether the issuing bank's customer gives the issuing bank cash, a note, or nothing at all, the beneficiary of the letter of credit never places anything of value in the bank. Instead, he simply relies on the credit of the bank by accepting its letter of credit. Similarly, the FDIA expressly provides deposit insurance coverage to the holders of cashier's checks, money orders, and officer's checks, including checks "issued in payment for services, dividends, or purchases . . . ." 12 U.S.C. § 1813(*l*)(4). Thus, trade creditors, recipients of money orders and dividend payments, and a wide range of other parties who receive checks from insured banks enjoy insurance protection whether or not they entrust anything of value to the bank. If the purpose of the deposit insurance system had been as narrow as FDIC contends, Congress would not have extended insurance protection to any of these parties. FDIC's crabbed "entrustment" theory and the related distinction between "funded" and "unfunded" letters of credit simply do not jibe with the language or the legislative history of the FDIA.

In trying to reconcile its purported distinction between "funded" and "unfunded" letters of credit with the language of Section 1813(*l*)(1), FDIC insists that the promissory note proviso of the statute applies only to instruments that represent "an unconditional liability" at the time of delivery. FDIC Br. at 17. Applying this newly developed standard[5] to the documents at issue in

[5] Previously, FDIC has tried to explain away the promissory note proviso by claiming that it is intended to cover situations in which an issuing bank makes a loan to its customer, receives a promissory note evidencing the loan, retains the loan proceeds in a bank account, and issues a letter of credit in exchange for the loan proceeds. Brief for Appellant at 20 (filed April 17, 1985), *Allen v. FDIC*, No. 85-5003 (6th Cir. 1985). This argument fails, however, because a letter of credit issued in exchange for the proceeds of the issuing bank's loan is issued in exchange for cash, not for the customer's promissory note. Apparently recognizing this infirmity in the argument it so recently presented to the Sixth Circuit, FDIC has shifted to the "unconditional liability" theory.

this case, FDIC concludes that the demand note given to the issuing bank "was not a 'promissory note' of the type that meaningfully may be termed the equivalent of money." FDIC Br. at 16. FDIC offers negligible authority for its "unconditional liability" theory,[6] but still

[6] FDIC's principal authority consists of two references to the legislative history of the FDIA: remarks of Representative Busby in connection with the with the Federal Reserve Act amendments that created FDIC, and testimony of William G. Loeffler, FDIC's Controller, in connection with the 1960 amendments to the FDIA. *See* FDIC Br. at 17-18. Representative Busby's remarks, to the extent that they shed any light on the subsequent definition of "deposit," merely recognize that loan proceeds, like other funds placed in a bank, constitute deposits and are entitled to protection, 77 Cong. Rec. 3905 (1933); Loeffler's testimony, while ambiguous, apparently contradicts FDIC's current position by suggesting that if a bank purchases a promissory note by giving credit (*e.g.*, in the form of a letter of credit) a "deposit" is created. *See Federal Deposit Insurance Act: Hearings on H.R. 8916 and H.R. 8928 Before Subcomm. of the House Comm. on Banking and Currency*, 86th Cong., 2d Sess. 26 (1960).

FDIC also contends that "when the current statutory definition [of deposit] first became effective in 1935 . . . a contingent note generally was not understood to be [a] 'promissory note' within the ordinary meaning of that term." FDIC Br. at 18. As authority for this proposition, FDIC cites only two sources: the 1930 version of Federal Reserve Board Regulation A (defining "the character of a note, draft, or bill of exchange *eligible for discount* at a Federal reserve bank . . . ."), 16 Fed. Res. Bull. 520 (1930) (emphasis added), and *Gilman v. Commissioner of Internal Revenue*, 53 F.2d 47 (8th Cir. 1931) (holding that a taxpayer's promissory notes given to his wife and children without consideration did not constitute "indebtedness" the interest on which could be deducted in determining the taxpayer's net income). Neither of these authorities indicates anything about the general understanding of the term "promissory note" in 1935, let alone in 1960, when Congress enacted the statutory definition of "deposit." In 1935, in 1960, and today it was and is clear that an express or implied condition does not affect the character of an instrument as a promissory note. *See, e.g., Bruner-Goodhue-Cooke-Cranz Agency Co. v. Smith*, 25

declares that "it is impossible to imagine why Congress would have wanted a standby letter of credit backed by a conditional note" to be viewed as a deposit. FDIC Br. at 19.

In attempting to explain the promissory note proviso, FDIC again proceeds from its erroneous premise that the deposit insurance program was intended solely to protect those who entrust their "hard earnings" to insured banks. Plainly, other considerations—including the desire to protect those who rely on the credit of banks—influenced the statutory definition of "deposit." At least in the case of letters of credit, these considerations apparently included safeguarding the ability of an issuing bank (or FDIC as its receiver) to obtain payment from the bank's customer once the bank learns that it will have to make payment under its letter. This helps to explain why Congress required that promissory notes be deemed "the equivalent of money."

Viewing a letter of credit transaction from the standpoint of the issuing bank, it is obvious that by obtaining a promissory note from its customer, the bank can enhance its prospects of obtaining payment if it becomes necessary for the bank to make payment under the letter of credit. The promissory note may, for example, be partially or fully secured; it may provide for periodic payments independent of the timing of drafts under the letter of credit; it may bear the signatures of one or more accommodation parties (or it may be the note of another maker, on which the bank's customer is only secondarily liable); or it may contain a confession-of-judgment clause enabling the holder to obtain judicial

Ohio App. 21, 157 N.E. 407 (1927); *Thompson v. Kay*, 95 Utah 272, 80 P.2d 335 (1938); 7A C. Nichols & R. Moore, *Cyclopedia of Legal Forms Annotated* § 7.1744 n.70 (rev. vol. 1959); *Payne v. Terry*, 367 S.W.2d 277, 279 n.1 (Ky. 1963); *Evenson v. Hlebechuk*, 305 N.W.2d 13 (N.D. 1981); *Leroux v. Doniphan Retirement Home, Inc.*, 663 S.W.2d 791 (Mo. App. 1984).

liens immediately after maturity or even prior to maturity.[7] In short, a bank customer's promissory note can be structured in a wide variety of ways that help to protect the bank (and any subsequent holder of the note) but that do not constitute the note as an "unconditional liability" of the customer or make the letter a "funded" letter.[8]

Even if the customer's promissory note contains none of these extra protections, the use of a note can simplify collection from the customer, because a note (as distinct from a reimbursement agreement) constitutes a fixed, liquidated payment obligation, under which all applicable conditions (other than any conditions contained in the note itself) are presumed to have been satisfied.[9] Thus,

[7] While the use of confession-of-judgment notes is restricted in many jurisdictions and prohibited in some, the use of such notes, where they are enforceable, can give the holders enormous leverage. *See, e.g., D.H. Overmyer Co. v. Frick Co.*, 405 U.S. 174, 176-78 (1971); Federal Trade Commission, Statement of Basis and Purpose and Regulatory Analysis, 49 Fed. Reg. 7748-55 (March 1, 1984) (FTC rule prohibiting use of confession-of-judgment clauses in consumer transactions).

[8] FDIC's distinctions simply make no sense. If, for example, the customer's note is not payable until there is a draw on the letter of credit and the note is fully secured, the note still is not an "unconditional liability" and does not make the letter "funded." The same is apparently true if the customer's note provides for partial payment prior to a draw on the letter of credit or permits the bank to demand payment prior to a draw.

[9] *See Penn Mut. Life Insurance Co. v. Orr*, 217 Iowa 1022, 252 N.W. 745 (1933) ("It is a rule of law so well established as to require no citation of authorities that the signer of a promissory note is presumptively liable thereon"); *Farmers' Bank of Billings v. Schmidt*, 25 S.W.2d 525 (Mo. App. 1930). *Cf. Richardson's Adm'r v. Morgan*, 233 Ky. 540, 26 S.W.2d 32 (1930); N.Y. Civ. Prac. Law § 3213 (McKinney 1970) (providing for summary judgment motion in lieu of complaint if the "action is based upon an instrument for the payment of money only"). These same enforcement considerations are largely responsible for the practice—universal among lending institutions—of requiring borrowers to execute promissory

a bank is likely to encounter substantially fewer problems of proof in enforcing its customer's promissory note than in enforcing a reimbursement agreement.[10] FDIC itself has expressly recognized the intrinsic value of promissory notes in its one published interpretation concerning the "deposit" status of letters of credit. *See* 12 C.F.R. § 327.209(b) (1959) (indicating that a letter of credit issued in exchange for the account party's promissory note—as distinct from its reimbursement agreement—constitutes a deposit and is subject to assessment). *Cf.* 12 C.F.R. § 327.119 (1959); 12 C.F.R. § 327.228 (1959).

The use of promissory notes can also help to avoid a problem that arose repeatedly in the bank failures of the 1930's: the application, following the insolvency of a bank, of payments made by customers to cover drafts under the bank's letters of credit. Receivers for failed banks commonly took the position that they were entitled to collect such payments and then to treat them as general assets of the banks, distributable pro rata, rather than as special assets to be made available to the letter of credit beneficiaries.[11] This potential mis-

notes in conjunction with written loan agreements. Lenders follow this practice religiously, even when they are documenting revolving credit arrangements, construction loans, and other credits in which the borrowers' obligations are conditioned on the making (and amount) of advances by the lender.

[10] This is especially true because of the tripartite nature of letter of credit transactions and the risk that the bank's customer, in contesting liability under a reimbursement agreement, will assert defenses based on the terms of the letter of credit itself (*i.e.*, the contract between the bank and the beneficiary) or based on the underlying contract between the beneficiary and the customer. *See generally* Thayer, *Irrevocable Credits in International Commerce: Their Legal Effects*, 37 Colum. L. Rev. 1326, 1347 (1937). This risk is diminished when the customer's payment obligation is represented by an independent instrument, *i.e.*, a promissory note.

[11] *See, e.g., Greenough v. Munroe*, 53 F.2d 362 (2d Cir.), *cert. denied*, 284 U.S. 672 (1931); *Bank of United States v. Seltzer*, 233

application of funds was of concern not merely to letter of credit customers and beneficiaries but also to FDIC, because when FDIC pays a beneficiary's insurance claim, FDIC becomes subrogated to the beneficiary's rights. *See* 12 U.S.C. § 1821(g). The problem could be alleviated, however, by the use of a promissory note putting the customer's obligation in tangible form and tying it directly to the bank's obligations under the letter of credit.[12]

Thus, the inclusion of promissory notes in the proviso to Section 1813(*l*)(1) reflected a variety of diverse concerns. It is these concerns—not merely Congress' desire to protect "hard earnings" entrusted to banks—that prompted Congress to accord special treatment to credit instruments issued in exchange for promissory notes. This Court need not and should not attempt to rewrite the plain language of the FDIA to make it consistent with FDIC's overly narrow view of congressional intent. If, as FDIC suggests, it is undesirable to cover "unfunded" letters of credit as insured deposits, it is the province of Congress to change the statute accordingly. *Sedima S.P.R.L. v. Imrex Co.*, 105 S. Ct. 3275, 3287 (1985) ("[the] defect—if defect it is—is inherent in the

App. Div. 225, 251 N.Y.S. 637 (1931); *Shawmut Corp. v. Bobrick Sales Corp.*, 260 N.Y. 499, 184 N.E. 68 (1933). *See also Taussig v. Carnegie Trust Co.*, 156 App. Div. 519, 141 N.Y.S. 347 (1913), *aff'd*, 213 N.Y. 627, 107 N.E. 1086 (1914); *Kuehne v. Union Trust Co.*, 133 Mich. 602, 95 N.W. 715 (1903). *See generally* Neidle & Bishop, *Commercial Letters of Credit: Effect of Suspension of Issuing Bank*, 32 Colum. L. Rev. 1, 5, 9-24 (1932); W. Ward & H. Harfield, *Bank Credits and Acceptances* 245-54 (4th ed. 1958).

[12] The problem of application of the bank customer's payments is now addressed in Section 5-117 of the Uniform Commercial Code (the "UCC"). In 1960, however, the UCC had only been adopted in a handful of jurisdictions. Even today, Article 5 is partially or wholly inapplicable in New York and in several other states that have followed New York in adopting a non-uniform version of UCC § 5-102(4). *See* N.Y. UCC § 5-102(4) (McKinney 1964); J. Dolan, *The Law of Letters of Credit* ¶ 4.05 at 4-13 (1984).

statute as written, and its correction must lie with Congress"). In fact, FDIC has already proposed legislation that would eliminate all letters of credit from the FDIA definition of deposit.[13] This Court should simply apply the clear words of the FDIA to hold that a letter of credit issued in exchange for a promissory note evidences an insured deposit under the FDIA.

B. FDIC Has No Administrative Interpretation Entitled to Any Judicial Deference.

FDIC and its allied *amici* seek to vindicate their misreading of the FDIA by claiming that since 1935 FDIC has "informally but consistently declined to treat" unfunded standby letters of credit as deposits. FDIC Br. at 24. This "informal" interpretation, FDIC contends, presents the "clearest imaginable case for deference to the FDIC." FDIC Br. at 26. Seldom has any administrative agency urged a federal court to defer to such a doubtful administrative interpretation, based on such a slender administrative record.

As respondent Philadelphia Gear has pointed out, FDIC's purported administrative interpretation has appeared to gain new stature as this case has moved from court to court. At the trial level, FDIC did not claim any long-standing administrative interpretation. In appealing to the Tenth Circuit, FDIC claimed that it had a long-standing interpretation excluding all standby letters of credit (whether "funded" or "unfunded") from the definition of deposit. Combined Reply

[13] *See* S. 760, 99th Cong., 1st Sess. § 3 (1985), *reprinted in* 131 Cong. Rec. S3466 (daily ed. March 26, 1985); *see also FDIC, Section-By-Section Analysis*, 131 Cong. Rec. at S3472 (daily ed. March 26, 1985). The bill, introduced in Congress at FDIC's request, would eliminate all letters of credit—"funded" or "unfunded" —from § 1813(*l*)(1). The fact that FDIC proposes to amend the statute in this manner, instead of excluding "unfunded" letters of credit, suggests that the distinction between "funded" and "unfunded" letters of credit is neither as important nor as venerable as FDIC has urged.

Brief of FDIC, In Its Corporate Capacity And In Its Capacity As Receiver of Penn Square Bank, N.A. at 11 (September 14, 1984). Before this Court, FDIC urges a distinction between "funded" and "unfunded" letters of credit, regardless of whether they are standby letters.

Neither version of FDIC's supposedly long-standing interpretation finds any support in the statute itself, in the legislative history of the statute, in FDIC's regulations, including those pertaining to assessment of deposits and payment of insurance proceeds,[14] or in FDIC's published brochures describing the types of deposits insured under the FDIA.[15] Indeed, neither FDIC nor the allied *amici* have been able to point to anything generated by FDIC in the last 50 years that confirms the existence of FDIC's alleged administrative interpretation, let alone its correctness.

Reduced to its essentials, the administrative interpretation argument advanced by FDIC and its allied *amici*

[14] *See, e.g.*, 12 C.F.R. Part 327 ("Assessments") and 12 C.F.R. Part 330 ("Clarification and Definition of Deposit Insurance Coverage").

[15] FDIC furnishes to insured banks for distribution to their depositors promotional brochures bearing titles like "Your Insured Deposit," and "How FDIC Safeguards Your Deposits Here." Until recently, all or most of these brochures contained the following question and answer:

> What types of deposits are insured?
>
> All types of deposits received by a bank in its usual course of business are insured, including savings deposits, checking deposits, Christmas savings and other open-account time deposits, time certificates of deposit, uninvested trust funds, certified checks, cashier's checks, officers' checks, money and drafts, letters of credit, and travelers' checks for which an insured bank is primarily liable.

FDIC, *Your Insured Deposit* ¶ 4, quoted in *Allen v. FDIC*, 599 F. Supp. 104, 106 (E.D. Tenn. 1984). Recently, FDIC has published a revised issue of this same brochure indicating, for the first time, that only "funded" letters of credit are insured deposits. FDIC, *Your Insured Deposit* ¶ 4.

depends on three propositions, none of which can withstand serious analysis: (i) that FDIC began excluding "unfunded" letters of credit in 1935, an exclusion ratified by Congress when it subsequently amended the FDIA; (ii) that FDIC "never has assessed insurance premiums on letters of credit of the sort at issue here," FDIC Br. at 10; and (iii) that FDIC "never has paid out on insurance claims relating to such letters . . . ." *Id.*

FDIC's Pronouncement in 1935. According to both FDIC and the *amici*, FDIC first articulated its "funded" versus "unfunded" distribution at an informal meeting of FDIC officials and New York bank personnel held in 1935. Notes from this meeting were transcribed, edited, and apparently circulated in the form of a Transcript of Notes Taken at Special Meeting of N.Y. Bank Comptrollers and Auditors Conference Held September 27 and 28, 1935 (the "1935 Transcript"). *See FDIC v. Irving Trust Co.*, 137 F. Supp. 145, 160-61 (S.D.N.Y. 1955). The 1935 Transcript has never been published, let alone incorporated in any FDIC regulation, and, as the *Irving Trust* court concluded, "the answers in the transcript appear at best to be of only slight value . . . ." *Id.* at 161. The discussion was, by FDIC's own admission, tentative, and in the *Irving Trust* case FDIC itself "sharply disputed" the admissibility of the transcript. *Id.* From a 26-page transcript, FDIC and the industry *amici* cite only one brief passage, which, when read in context, indicates that FDIC's representative was focusing on letters of credit issued in exchange for cash, not letters of credit issued in exchange for promissory notes or other cash equivalents.[16] This one doubtful dictum—contained in a transcript disavowed by FDIC more than

[16] FDIC Br. at 24; American Bankers Assoc. Br. at 6, Council on Int'l Banking, Inc. Br. at 14 (quoting answer of Henry W. Riley to the question "Is a letter of credit issued by a charge against a customer's account a deposit liability?").

30 years ago— represents FDIC's only arguable articulation (prior to this litigation) of the administrative interpretation that, according to FDIC, "present[s] the clearest imaginable case" for judicial deference.[17]

FDIC's Assessment Practice. FDIC asserts, without benefit of any citation, that it "never has assessed insurance premiums" on "unfunded" letters of credit of the kind issued to Philadelphia Gear. FDIC Br. at 24. Even if this statement is true, it would be irrelevant to the question presented in this case, because FDIC's practice in assessing or failing to assess deposits simply cannot govern the availability of insurance to the hold-

[17] FDIC and the *amici* seek to dignify their meager excerpt from the 1935 Transcript by suggesting that it was "judicially approved" (American Bankers Assoc. Br. at 8) or, at least, judicially recognized (FDIC Br. at 24) in the *Irving Trust* case. *Irving Trust*, however, concerned the "deposit" status of fourteen categories of accounts containing or representing actual funds received and held by banks. Thus, the portion of the decision that discusses the definition of "deposit" turns entirely on what is now § 1813(*l*)(3) and does not purport to consider § 1813(*l*)(1). While the *Irving Trust* court did cite FDIC's favorite excerpt from the 1935 Transcript, the court did so only in dictum and after concluding that this and other answers in the transcript were "at best . . . of only slight value . . . ."

FDIC and the industry *amici* also suggest that Congress somehow ratified FDIC's alleged interpretation when it amended the FDIA in 1950 and 1960. FDIC Br. at 25-26; American Bankers Assoc. Br. at 819. As FDIC observes, an administrative agency can be presumed to have correctly interpreted its statute when the "agency's statutory construction has been 'fully brought to the attention of the public and the Congress' and the latter has not sought to alter that interpretation although it has amended the statute in other respects . . . ." *United States v. Rutherford*, 442 U.S. 544, 554 n.10 (1979) (quoting *Apex Hosiery Co. v. Leader*, 310 U.S. 469, 489 (1940)). It is little short of preposterous, however, to suggest that FDIC's alleged administrative interpretation—an interpretation presented, if at all, only as an aside in the outdated and repudiated 1935 Transcript and echoed in dictum in *Irving Trust*—was "fully brought to the attention" of anyone, let alone the public and the Congress.

ers of those deposits. If, for example, FDIC neglected to collect assessments on some category of deposit certificates or savings accounts, it could hardly be heard to argue that the holders of those certificates or accounts were not entitled to insurance.

FDIC's Practice in Paying Insurance Claims. FDIC contends, again without citation, that it has "never paid out on insurance claims" relating to "unfunded" letters of credit. FDIC Br. at 24. Assuming that this statement is true, it is surely also true that FDIC has never refused to make payment on such insurance claims. The simple fact is that prior to the *Philadelphia Gear* and *Allen* cases, there were no reported instances in which either FDIC or any court was called upon to consider the "deposit" status of letters of credit issued in exchange for promissory notes.[18] FDIC can hardly premise a long-standing administrative interpretation on its failure to pay insurance claims that it has apparently never had any reason to consider.

FDIC's vaunted administrative interpretation thus consists of little more than 50 years of undocumented inattention, for which its appellate counsel has attempted to develop a *post hoc* rationalization. Plainly, this is not the kind of considered administrative interpretation to which the Court should defer, particularly where deference would require departure from the plain language of the statute.

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[18] The paucity of litigation in this area is hardly surprising. As discussed at 25 n.28, *infra*, the use of promissory notes in connection with the issuance of letters of credit appears to be relatively rare, and the holders of these rare letters of credit have no occasion to make insurance claims unless the account party has failed to pay, the issuing bank has been closed, and the issuing bank's liabilities under outstanding letters of credit have not been assumed by another bank or otherwise satisfied from the assets of the closed bank.

II. In Enacting the Deficit Reduction Act of 1984, Congress Recognized That Letters of Credit Can Be Insured Deposits And Sought To Preserve Tax Exemption for Municipal Bonds Backed by Letters of Credit.

FDIC contends that Congress recently "legislated with FDIC's reading of Section 1813(*l*)(1) in mind" when it enacted Section 622 of DEFRA, which denies tax exemption to municipal bonds that are "federally guaranteed." FDIC and its allied *amici* imply that the legislative history of this 1984 tax legislation indicates some present understanding by Congress that letters of credit are not insured deposits under Section 1813(*l*)(1).[19] They then argue, based on their misinterpretation of DEFRA, that the holding of the court of appeals may disrupt the bond market by threatening the tax-exempt status of municipal bonds backed by insured letters of credit.

These arguments are incorrect and reflect a serious misreading of the legislative history of DEFRA. First, the 1984 legislative history of DEFRA shows nothing about the intent of the 1960 Congress which enacted the FDIA definition of "deposit." A subsequent Congress cannot ordinarily define the intent of a prior Congress: "It is the intent of the Congress that enacted [the section] . . . that controls." *Oscar Mayer & Co. v. Evans*, 441 U.S. 750, 758 (1979) (quoting *Teamsters v. United States*, 431 U.S. 324, 354 n.39 (1977)). This is especially true in this case, where the subsequent pronouncement is a staff report that postdates the original legislation by 24 years. *See Oscar Mayer*, 441 U.S. at 758 (Senate report written 11 years after the original legislation); *United Airlines, Inc. v. McMann*, 434 U.S. 192, 200 n.7 (1977) ("legislative observations" ten years after the original Act). *Cf. Mohasco Corp. v. Silver*, 447 U.S. 807, 823-24 (1980).

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[19] FDIC Br. at 26 n.21, 29-30; U.S. Conference of Mayors Br. at 9-11; American Bankers Assoc. Br. at 10-11.

Moreover, contrary to the assertions of FDIC and *amici*, the actual legislative history of DEFRA shows that the 1984 Congress recognized that letters of credit could be insured deposits. It also shows that Congress enacted Section 622 of DEFRA in part to assure that municipal bonds backed by such letters of credit would retain their tax exemption. As the full legislative history shows, the provisions of DEFRA concerning tax exemption for federally guaranteed obligations were shaped by Congress' desire to prevent a specific abuse: transactions in which a state or local government would issue bonds and deposit the proceeds in insured deposit accounts at banks that would lend the proceeds back to the issuer. Because no bondholder invested more than $100,000, each bondholder's investment was fully covered by FDIC insurance. Both houses of Congress considered bills designed to eliminate this abuse, consistent with the general federal policy against "double-dips." [20]

The tax bill first reported out by the House Ways and Means Committee included not only the specific language of these two bills but also broader language denying tax exemptions for all obligations directly or indirectly guaranteed by the Federal government. H.R. 4170, 98th Cong.,

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[20] H.R. 1635, 98th Cong., 1st Sess. (1983); S. 1061, 98th Cong., 1st Sess. (1983).

For a more detailed description of this transaction, *see Trends in Municipal Financing and the Use of Tax-Exempt Bonds to Finance Private Activities: Hearings Before the House Comm. on Ways and Means*, 98th Cong., 1st Sess. 11-12, 18-19 (June 15 and 16, 1983) ("House Hearings") (statement of John E. Chapoton, Assistant Secretary of the Treasury); *Housing Finance Opportunity Act and Denial of Tax Exemption to Certain Bonds Guaranteed by Federal Agencies: Hearing Before the Subcomm. on Taxation and Debt Management of the Senate Comm. on Finance*, 98th Cong., 1st Sess. 16-19 (May 13, 1983) ("Senate Hearings") (description of the bill by the Joint Committee on Taxation); 129 Cong. Rec. H636-37 (daily ed. Feb. 24, 1983) (statement of Rep. Pickle, sponsor of H.R. 1635).

1st Sess. § 722(h) (October 21, 1983). The Ways and Means Committee limited this broad language, however, both in its October bill and in a March 1984 revision by specifying certain categories of guaranees which, although provided by federal agencies, would nevertheless not be considered "federal guarantees" resulting in the loss of tax exemption. *See* H.R. 4170, 98th Cong., 2d Sess. § 722(h)(3) (March 5, 1984). Among these exceptions were guarantees by the Federal Housing Administration, the Veterans' Administration, the Federal National Mortgage Association, and the Small Business Administration. *Id.* The final exception, the crucial one in this case, stated that an obligation "shall not be treated as federally guaranteed merely by reason of the fact that . . . there is a guarantee by a financial institution." *Id.* § 722(h)(3)(D). The Ways and Means Committee's supplemental report explained:

> Another exception to the general denial of tax-exemption provides that obligations shall not be treated as Federally guaranteed solely because . . . a financial institution guarantees repayment of the loans (*e.g.*, issues a letter of credit).[21]

Thus, the Committee recognized, shortly after the district court's February 1984 decision in this case, that a letter of credit could be an insured deposit, and it chose to retain the tax exemption for obligations backed by a letter of credit.[22]

The Ways and Means Committee proposal on federal guarantees was adopted by the House and the Conference

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[21] H.R. Rep. No. 432 Part 2, 98th Cong., 2d Sess. 1690 (March 5, 1984).

[22] The Ways and Means Committee supplemental report clarifies that the general denial of tax exemption was intended to apply where "a substantial portion" of a bond issue is "federally guaranteed." *Id.* at 1685. Because a bond issue backed by an insured letter of credit can only enjoy deposit insurance for a minimal portion of its proceeds (*i.e.*, $100,000), it does not represent the abusive double-dip to which this bill applied.

Committee and signed into law as part of DEFRA on July 18, 1984.[23] Five months later, however, the staff of the Joint Committee on Taxation issued a staff explanation of "federally guaranteed" which was substantially different from the explanation in the actual legislative history. The staff report copied the language of the Ways and Means Committee supplemental report but twisted its meaning by inserting an added phrase:

> A further exception provides that obligations are not treated as Federally guaranteed solely because . . . a financial institution guarantees repayment of the loans *other than by means of Federal deposit insurance* (*e.g.*, by a letter of credit).[24]

Thus, reliance by FDIC and the *amici* on this dubious staff explanation,[25] which finds no support in the actual legislative history, is misguided. Congress evidently intended Section 622 of DEFRA to preserve tax exemption for municipal bonds backed by letters of credit, not to pronounce, as the staff report implies, that letters of credit are not covered by deposit insurance. For this reason, affirmance of the lower court decision in this case will not affect the tax-exempt status of obligations backed by letters of credit and need not disrupt the bond market.

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[23] The Conference report did not explain the definition of "federally guaranteed." H.R. Rep. No. 861, 98th Cong., 2d Sess. 1203-05 (June 23, 1984). In the final bill, § 722 of H.R. 4170 was renumbered to § 622, and the provision was eventually codified at 26 U.S.C.A. § 103(h) (Supp. 1985).

[24] Staff of Joint Comm. on Taxation, 98th Cong., 2d Sess. 941, *General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984* (Joint Comm. Print Dec. 31, 1984) (emphasis added).

[25] The Internal Revenue Service has recognized that even when such staff explanations are consistent with the legislative history they "are not authority" in resolving tax disputes. Treas. Reg. § 1.6661-3(b)(2) (1985).

III. Application of the FDIA's Clear Language Will Have No Substantial Impact on the Banking System or the Bond Market.

FDIC and several *amici* have suggested that application of the FDIA's clear language will bring under FDIC's insurance umbrella a huge amourt of new liabilities, exposing the Insurance Fund to unexpected risk and exposing member banks to unexpected deposit insurance premiums. These threats and fears are both groundless and misdirected.

FDIC invents facts when it insists that the FDIA's plain language—as applied by the lower court—creates additional risks for the Insurance Fund and new premium obligations for insured banks. In its Petition for Certiorari FDIC estimated that there are some $120 billion in outstanding standby letters ("funded" and "unfunded"), on which banks would be required to pay roughly $100 million in deposit insurance premiums.[26] FDIC now shifts position, explaining in its brief on the merits that the $120 billion figure represents not *all* standby letters, as FDIC previously maintained, but only the "unfunded" letters that FDIC contends were brought within the scope of insurance coverage by the courts below.[27] This estimate, like its predecessor, has no support in the record. Indeed, FDIC has conceded that it has no statistics on the dollar amount of outstanding standby letters of credit issued in exchange for promissory notes[28] —the only letters to which the Tenth Circuit's decision applies. 751 F.2d at 1134-35.

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[26] Petition for Certiorari at 19 (June 1985); *see also* Reply Memorandum for the Petitioner in Support of Certiorari at 4 n.3 (October 1985).

[27] FDIC Br. at 27.

[28] Reply Memorandum for the Petitioner in Support of Certiorari at 4 n.3 (October 1985). *Cf.* American Bankers Assoc. Br. at 2-3

In any event, FDIC's estimates obviously exaggerate the additional exposure confronting the Insurance Fund. The Insurance Fund faces liability on a standby letter only if the account party defaults on his obligation to the beneficiary and the issuing bank fails, and then only up to $100,000 (less whatever FDIC recovers as the beneficiary's subrogee).

FDIC has acknowledged that it is fully capable of protecting the Insurance Fund by assessing premiums on insured standby letters. FDIC Br. at 28. FDIC protests that while additional premiums would protect the Insurance Fund they would overly burden banking institutions. *Id.* But additional premiums would impose little, if any, burden. Banks issuing standby letters can avoid additional deposit insurance premiums altogether by issuing letters that do not fall within the FDIA's definition of deposits. Most obviously, they can refrain from taking promissory notes.[29]

(stating vaguely that "a material percentage" of all outstanding standby letters are backed by promissory notes).

It appears that standby letters issued in exchange for promissory notes represent only a small fraction of the total amount of standby letters issued by FDIC-insured banks, for most banks apparently have not made it a standard practice to obtain promissory notes from customers for whom they issue standby letters. For example, UAB Knoxville, which issued *amici*'s letters, appears generally to have relied on a reimbursement agreement signed by its account party. Of some $55 million in standby letters issued by UAB Knoxville and outstanding at the time it failed, only about five percent ($2.8 million) appear to have been issued in exchange for promissory notes.

[29] Despite FDIC's suggestions to the contrary, there appears to be no reason to anticipate that the courts—or FDIC's assessment auditors—will have any difficulty distinguishing promissory notes (which give rise to deposit status) from other forms of documentation such as reimbursement agreements (which do not). *See First Tennessee Bank v. FDIC*, No. 3-84-273 (E.D. Tenn. Apr. 12, 1985) (Mag. Murrian).

In the rare case[30] when an issuing bank finds it necessary to issue a standby letter that qualifies as an insured deposit, the bank can adjust its fee slightly to pass the cost of deposit insurance premiums through directly to its customer. Under the assessment formula contained in 12 U.S.C. § 1817(b), this adjustment would amount to only one-twelfth of one percent (0.083%) of the face amount of the insured standby letter.[31]

Finally, FDIC and allied *amici* warn that the FDIA's clear definition of "deposits" may interact with DEFRA to jeopardize the tax-exempt status of municipal bonds backed by standby letters of credit. As *amici* have shown, *see* Section II, *supra*, in light of DEFRA's language and its legislative history, and in light of the various ways in which bond issuers can obtain standby letters documented to avoid "deposit" status, application of the FDIA's plain language simply does not threaten the tax exemption for bond issues.

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[30] Standby letters are commonly used in transactions so large that the availability of $100,000 in deposit insurance is likely to be of negligible concern to the beneficiaries.

[31] FDIC expresses its fear that this additional cost may place American banks at a "serious disadvantage" in competing with "foreign or other non-insured institutions" for standby letter transactions. FDIC Br. at 28-29. This argument is preposterous. In the large transactions for which banks might compete, $100,000 in deposit insurance will be nearly irrelevant, and member banks can avoid the cost of additional premiums by structuring their transactions so that their standby letters do not qualify as insured deposits.

CONCLUSION

The lower federal courts that have considered the issue unanimously agree that the FDIA's plain language provides deposit insurance protection to letters of credit backed by promissory notes. No calamity will result when this Court applies the statute's clear language affording broad insurance coverage. If, as FDIC contends, the statutory language requires revision, that task belongs to Congress.

Respectfully submitted,

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